

INTERMEDIATE (IPC) COURSE

STUDY MATERIAL

PAPER : 4

Taxation

Part – II : Indirect Taxes

[Relevant for May, 2015 and November, 2015
Examinations]

As amended by the Finance (No.2) Act, 2014



BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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A WORD ABOUT STUDY MATERIAL

Taxation is one of the core competence areas of Chartered Accountants. Chartered Accountants are expected to advise clients and organizations, especially in the corporate sector, in the area of tax management and planning pertaining to both direct and indirect taxes. Considering the importance of the subject, the same has been included in the syllabus of both Intermediate (IPC) Course and Final Course of the Chartered Accountancy curriculum. Whereas in Intermediate (IPC) Course, both direct and indirect taxes have been included in one paper viz., Paper 4: Taxation; in Final Course, direct and indirect taxes have been allocated separate papers namely, Paper 7: Direct Tax laws and Paper 8: Indirect Tax Laws.

Paper 4: Taxation of Intermediate (IPC) Course has two parts; Part – I : Income-tax and Part – II : Indirect Taxes. Students are expected to acquire working knowledge in indirect taxes after undergoing this course.

This Study Material includes laws relating to central excise duty, customs duty, central sales tax, VAT and service tax. In line with the syllabus of Part - II of this Paper, the discussion on central excise duty, customs duty, central sales tax and VAT are aimed at introducing the students to the basic concepts of substantive law of such taxes as also familiarizing them with the basic aspects of the significant procedures thereof. However, the provisions relating to service tax, which are included in the syllabus, have been discussed in detail. The subject matter in the Study Material is based on the law as amended by the Finance (No.2) Act, 2014.

No efforts have been spared in making this Study Material lucid and student friendly. Care has been taken to organize the Chapters in a logical sequence to facilitate easy understanding of the law. Nevertheless, students are requested to send their suggestions/feedback on how to make the Study Material more useful to them in the Feedback Form given at the end of the Study Material. They may also write to Faculty, Indirect Taxes at smita@icai.in and shefali.jain@icai.in.

Happy Reading and Best Wishes!

HIGHLIGHTS OF CHANGES IN STUDY MATERIAL

The Study Material has been updated with the amendments made vide the Finance (No.2) Act, 2014 and significant notifications/circulars issued between 01.05.2013 to 30.04.2014 as also the Budget Notifications. Such amendments have been given in ***bold italics*** in the respective Chapters for the convenience of students. The following table gives a summary of the various changes/amendments made in different Chapters of the Study Material:

| S.No. | Particulars | Section/Rule/ Notification | Chapter No. |
|---------------------|--|--|---------------------|
| Central Excise Duty | | | |
| 1. | E-payment of excise duty mandatory for all assessees irrespective of the duty paid during previous year | Rule 8(1B) of Central Excise Rules, 2002 | Unit 2 of Chapter 1 |
| Customs Duty | | | |
| 2. | Relevant date for determination of rate of duty and tariff valuation for imports through a vehicle to be the date of arrival of vehicle where bill of entry is filed prior to the arrival of the vehicle | Section 15(1) of Customs Act, 1962 | Unit 3 of Chapter 1 |
| 3. | Bill of entry to be filed prior to the delivery of import report if the vehicle in which the goods have been imported is expected to arrive within 30 days | Section 46(3) of Customs Act, 1962 | |
| 4. | Articles imported by an EOU/SEZ unit and cleared as such into DTA or used in the manufacture of final products that are cleared into DTA liable to safeguard duty | Section 8B of Customs Tariff Act, 1975 | |
| Service Tax | | | |
| I. | Chapter V of Finance Act, 1994 | | |
| 5. | Service tax to be levied on sale of space or time for advertisements in all media except print media | Section 66D(g) | Chapter 2 |
| 6. | Radio taxis/radio cabs liable to service tax | Section 66D(o) | |
| 7. | Rate of exchange under section 67A to be determined as per GAAP | Section 67A | |

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|-------------|--|---------------------|-----------|
| 8. | Clarification on whether "agricultural produce" includes rice and benefits available in respect of rice under mega exemption notification | | |
| II. | Point of Taxation Rules, 2011 | | |
| 9. | Rule 7 to override the provisions of rules 3, 4 and 8 only | Rule 7 | Chapter 3 |
| 10. | Point of taxation under reverse charge to be the payment date or the first day occurring immediately after three months from the date of invoice, whichever is earlier | Rule 7 | |
| III. | Service Tax Rules, 1994 | | |
| 11. | Service tax to be payable by the recipient of service in case of services provided by recovery agents to banks, financial institutions and NBFC | Rule 2(1)(d)(i)(AA) | Chapter 6 |
| 12. | Service tax to be payable by the recipient of service in case of service provided by a director to a body corporate | Rule 2(1)(d)(i)(EE) | |
| 13. | E-payment of service tax mandatory for all assessees irrespective of the tax paid during previous year | Rule 6(2) | |
| IV. | Others | | |
| 14. | Services provided by common bio-medical waste treatment facility operators to clinical establishments exempted | | Chapter 5 |
| 15. | Transport of organic manure by vessel, rail or road (by GTA) exempted | | |
| 16. | IRDA approved life micro-insurance schemes with sum assured not exceeding ₹ 50,000 exempted | | |
| 17. | Loading, unloading, packing, storage or warehousing, transport by vessel, rail or road (GTA), of cotton - ginned or baled - exempted | | |
| 18. | Services received by RBI from outside India in relation to management of foreign exchange reserves exempted | | |
| 19. | Services provided by Indian tour operators to foreign tourists in relation to a tour wholly | | |

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|-----|--|--|-----------|
| | conducted outside India exempted | <i>Mega Exemption Notification No. 25/2012 ST dated 20.06.2012</i> | Chapter 5 |
| 20. | Limited exemptions in respect of services provided to Government or local authority or governmental authority | | |
| 21. | Concept of auxiliary education services done away with and exemption restricted to only few specific services | | |
| 22. | Exemption to transport of passengers in air-conditioned contract carriages withdrawn | | |
| 23. | Clinical research on human participants chargeable to service tax | | |
| 24. | Services provided by NSDC or by an approved SSC/assessment agency/training partner exempted | | |
| 25. | Loading/unloading/packing/storage/warehousing of rice exempted | | |
| 26. | Scope of definition of 'Governmental authority' widened | | |
| 27. | Expansion in the scope of exemption of services provided by way of sponsorship of sports events | | |
| 28. | Clarification regarding exemption available to services provided by a Resident Welfare Association (RWA) to its own members | | |
| 29. | Revised scheme of service tax exemption in case of services provided to SEZ unit/Developer | <i>Notification No. 40/2012 ST dated 20.06.2012</i> | |
| 30. | SEZ Notification amended for simplifying procedural compliance | <i>Notification No. 12/2013 ST dated 01.07.2013</i> | |
| 31. | Only service providers need to satisfy the condition of non- availment of credit for availing abatement in case of GTA service | | |
| 32. | Credit allowed on input service received by a person providing services of renting of motorcab | | |

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|-----------|--|--|-----------|
| | from a sub-contractor engaged in the similar line of business | <i>Abatement Notification No. 26/2012 ST dated 20.06.2012</i> | |
| 33. | 60% abatement prescribed for transport of passengers by a contract carriage (other than motorcab) and a radio taxi | | |
| 34. | Abatement in respect of transport of goods in a vessel increased from 50% to 60% | | |
| 35. | Credit allowed on input service received by a tour operator from a sub-contractor | | |
| 36. | Services tax to be paid under reverse charge in case of service provided by recovery agents to banks and directors to body corporate | <i>Reverse charge Notification No. 30/12 ST dated 20.06.2012</i> | Chapter 6 |
| 37. | Entire service tax to be paid by the service receiver in case of service provided by recovery agents to banks and directors to body corporate | | |
| 38. | Service receiver and provider to pay equal service tax on non-abated value in case of renting of motor vehicle | | |
| 39. | Slab rate of interest introduced for delayed payment of service tax | Section 75 | |
| V. | CENVAT Credit Rules, 2004 | | |
| 40. | Place of removal defined in the rules | Rule 2(qa) | Chapter 7 |
| 41. | Duty leviable on transaction value to be paid on removal of capital goods as waste and scrap | Rule 3(5A) | |
| 42. | CENVAT credit taken on input services to be reversed if duty paid on final product remitted | Rule 3(5C) | |
| 43. | Amount payable under sub-rules (5), (5A), (5B) and (5C) of rule 3 to be paid on or before the 5th day of the following month by utilizing CENVAT credit or otherwise | Rule 3(5C) | |
| 44. | Failure to reverse the credit taken on inputs and input services used in goods on which duty is ordered to be remitted also to attract recovery provisions under rule 14 [Explanation 2 to rule 3(5C)] | Rule 3(5C) | |

| | | | |
|-----|--|--------------------------------|-----------|
| 45. | Credit on inputs and input services to be availed within 6 months of the date of invoice | Sub-rule (1) and (7) of rule 4 | Chapter 7 |
| 46. | Payment of value of input service to service provider no more a pre-requisite for availing credit in case of service tax paid under full reverse charge | Rule 4(7) | |
| 47. | Condition of reversal of credit on failing to pay value of input service and service tax within 3 months of the date of invoice not to apply in case of full reverse charge | Rule 4(7) | |
| 48. | Credit reversed on account of non-receipt of export proceeds within the specified or extended period can be re-availed if export proceeds are received within one year from the specified or extended period | Rule 6(8) | |
| 49. | Procedure, safeguards, conditions and limitations prescribed for refund of CENVAT credit to service providers covered under partial reverse charge | Rule 5B | |
| 50. | Provisions relating to distribution of credit in case of input service distributor amended | Rule 7 | |
| 51. | Manner of distribution of common input service credit under rule 7(d) of the CENVAT Credit Rules, 2004 clarified | | |
| 52. | Importer required to file quarterly return | Rule 9(8) | |

STUDY PLAN – KEY TO EFFECTIVE LEARNING

Part – II: Indirect taxes

Indirect taxes play a pivotal role in the national economy as the central and state indirect taxes cumulatively contribute to more than 50% of the total tax revenue of the country. Being a major source of revenue, fiscal legislations lay a greater emphasis on levy of indirect taxes. Knowledge of indirect taxes is, therefore, very crucial and essential for a Chartered Accountant as one of his core function is to advise clients with regard to tax management and planning which necessarily entails a great degree of indirect taxes management.

Students are introduced to various significant indirect taxes at Intermediate (IPC) level in Part II: Indirect Taxes of Paper 4: Taxation. At this level, you are expected to develop an understanding of the basic concepts of the different types of indirect taxes and acquire the ability to analyse the significant provisions of service tax. Since the subject is totally new to you, you will have to first develop an understanding of the basic concepts of various indirect taxes. Furthermore, preparing this paper in a planned manner by drawing an effective Study Schedule is utmost essential.

The following procedure is recommended for the preparation of Part II: Indirect Taxes of Paper 4 Taxation (hereinafter referred to as “Part-II: Indirect Taxes”):

Step – 1: Know your syllabus

(i) First and the foremost, you should go through the syllabus of the paper carefully. The objective of the syllabus is to develop an understanding of the basic concepts of the different types of indirect taxes and to acquire the ability to analyse the significant provisions of service tax.

The contents of the syllabus are:

1. Introduction to excise duty, customs duty, central sales tax and VAT – Constitutional aspects, Basic concepts relating to levy, taxable event and related provisions
2. Significant provisions of service tax
 - (i) Constitutional Aspects
 - (ii) Basic Concepts and General Principles
 - (iii) Charge of service tax including negative list of services
 - (iv) Point of taxation of services
 - (v) Exemptions and Abatements
 - (vi) Valuation of taxable services

- (vii) Invoicing for taxable services
 - (viii) Payment of service tax
 - (ix) Registration
 - (x) Furnishing of returns
 - (xi) CENVAT Credit [Rule 1 -9 of CENVAT Credit Rules, 2004]
- (ii) There is no internal bifurcation of marks between various indirect taxes covered in the syllabus. Total 50 marks have been allocated to Part II: Indirect Taxes of Paper 4: Taxation. It is important to note that only general principles relating to State-Level VAT have been included in the syllabus. Students will not be examined with reference to any particular State VAT Law.

Step - 2: Get familiar with the knowledge inputs provided by the Board of Studies (BoS)

After going through the syllabus of the paper, the next step is to get familiar with the various publications/knowledge inputs provided by the Board of Studies with respect to Part II: Indirect Taxes. The following publications of the BoS need to be referred to while studying for this paper:-

- (i) **Study material** is the basic knowledge material provided with an aim to build a strong conceptual base by explaining the complex tax laws in a lucid manner. The Study Material is updated every year with the provisions of the relevant Finance Act and the relevant notifications and circulars.

Practice Manual contains a variety of questions and problems in each topic for the better understanding and application of the concepts explained in the Study Material. The Practice Manual is also updated regularly with the provisions of the relevant Finance Act and the relevant notifications and circulars.

- (ii) **Supplementary Study Paper** explains the amendments made by the annual Finance Act in Part-II: Indirect Taxes as well as the significant circulars and notifications issued by CBEC during last year.

It is especially relevant in case you have the earlier edition of the Study Material. However, even if you have the latest edition of the Study Material you are still advised to read the Supplementary Study Paper for a better understanding of the statutory amendments.

- (iii) **The Chartered Accountant Student** is the monthly Students' Journal which contains regular academic updates on the subject.
- (iv) **Revision Test Paper** helps the students to assess their preparation for the examination as also updates them with the latest statutory developments (which are applicable for the examination).

(vi) **Suggested Answers** contain the questions set at the CA examination, as well as the suggested answers to such questions. The answers are prepared with a view to assist the students in their education and generally represent the ideal manner in which questions should be answered. However, since they are prepared as per the provisions of law applicable for the respective examination, subsequent amendments made in the law should also be taken into consideration, while referring to the said answers.

(vii) **Mock Test Papers** are prepared to help the students assess their preparation under examination conditions. The pattern of setting the questions in the Mock Test Paper is the same as that of the Intermediate (Integrated Professional Competence) Examination.

Step - 3: Find out about the applicability of the Finance Act relevant for your examination

The Finance Act of a particular year would be applicable for the May and November examination of the next year. For instance, the amendments made by the Finance (No.2) Act, 2014 would be applicable for May, 2015 and November, 2015 examinations.

You are expected to be updated with the notifications, circulars and other legislative amendments made upto 6 months prior to the examination. For May examination, such amendments made upto 31st October of the previous year would be relevant and for November examination, such amendments made upto 30th April of that year would be relevant.

The following table depicts the applicability of the Finance Acts and the Notifications/Circulars for the May and November, 2015 examination:-

| | |
|----------------------------|---|
| May, 2015 Examination | Law as amended by the Finance (No.2) Act, 2014 and Notifications and circulars issued till 31.10.2014 |
| November, 2015 Examination | Law as amended by the Finance (No.2) Act, 2014 and Notifications and circulars issued till 30.04.2015 |

Step - 4: Make a comprehensive study plan

Planning your studies will definitely help in preparation of any paper. Making a detailed study plan with appropriate time allocation for all the topics will facilitate in completing your studies (along with revision) in time. Your planning for Part-II: Indirect Taxes should be such that you go through the paper at least thrice before the examination.

Since in Part-II: Indirect Taxes, the examination paper has a mix of practical and theoretical questions, you should do written practice of good number of both theory and practical questions on each topic. Therefore, at the time of planning the study, you should factor in the time for written practice. Always remember that you will be able to reap the benefits of a study plan only if you stick to your daily targets. Following your daily schedule religiously will lead to completing your studies well in time.

You may study at least two hours a day so that you are able to complete first round of entire study and two rounds of revision well before the examination. Your first round of study should be completed well in advance that is at least 3 months before your exam. This is a broad based planning about how to study but you should also pay attention to specific time planning for each and every chapter in detail - when to start and by what time the chapter should be completed. Keep some extra time as assimilation of the chapters may take more time than expected or planned.

Your second round of study i.e., your first revision should be over before one month of your exam. You should revise the second time in the last month before exam so that you are in a position to remember all the concepts. These three rounds of study will help in boosting the confidence level for the subject and will make you mentally prepared to appear in the examination.

Step - 5: Start the study for Part-II: Indirect Taxes

1. Study from the relevant Study Material for your examination as the Study Material which would have been given to you at the time of registration for Intermediate (Integrated Professional Competence) Course may not be applicable for your examination. For instance, you should study from **Study Material – October, 2014 Edition which is relevant for May, 2015 and November, 2015 examinations.**

Also, note that the Study Material relevant for May and November, 2015 examinations is updated with the amendments made by Finance (No.2) Act, 2014 and Notifications/circulars issued till 30.04.2014 as also the Budget Notifications. However, for May, 2015 examination, amendments made till 31.10.2014 will be relevant. In order to update the students with the amendments made between 01.05.2014 and 31.10.2014 as well, such amendments will be compiled and given in the RTP for May, 2015 examinations.

Similarly for November, 2015 examinations, amendments made till 30.04.2015 will be relevant and therefore, the amendments made between 01.05.2014 and 30.04.2015 will be compiled and given in the Revision Test Paper for the November, 2015 examinations.

2. You should go through each chapter meticulously to understand the concepts covered therein. A word of advice - keep the Bare Acts and the Relevant Rules of the relevant statutes by your side when you read the Study Material. This way you will become conversant with the sections of the Bare Acts and the related Rules, and understand their implications properly.

3. Prepare short summaries of each chapter and try to include all the key points of the chapter in the said summary. These summaries would be very useful for quick revision at the time of examination.

4. Work out practical problems from the corresponding chapter of Practice Manual after you complete the theory portion of a chapter from the Study Material.

5. Even if you study from the latest Study Material you should go through the Supplementary Study Paper to update yourself with the amendments made by the Finance Act, 1994 and the Notifications/Circulars issued during the last one year. While in the Study Material the amendments are incorporated at the relevant places without any discussion on the old provisions or the reason of introducing the amendments, the same are dealt in detail in the Supplementary Study Paper. Therefore, in order to get a complete understanding of the amendments, you are advised to go through the Supplementary Study Paper.

6. Another thing to be kept in mind while studying for this paper is that indirect tax laws is amended very frequently by notifications and circulars (clarifying the position of law) issued from time to time. Therefore, you must pay due attention to the compilation of amendments given in the Revision Test Paper of your examination.

7. Every day when you start a new topic, you should first go through the concepts which you have read last day and then start learning new concepts. Remember, out of sight, out of mind.

Special guidance for practical questions

You should work out the practical problems from Practice Manual on your own and then compare it with the solutions provided therein. At the time of first practice, mark the problems which contain some difficult issues or the problems which you find important from the examination point of view. Moreover, summarize the treatment of the said issues and mention it at the end of that question with a marker pen. When you practice the same chapter subsequently, pay special attention to these marked questions. This will help you in preparing a gist of critical issues and their treatment.

On the day before the examination, since it is not possible to solve all the practical questions in one day, going through the gist of these issues would suffice.

While solving the practical questions in examination, answers must be presented in a proper manner. You should give assumptions wherever required and should provide explanations for treatment of various items. Remember working notes/explanations carry marks and must be presented in a proper form. The length and depth of reasoning to be given would depend on the marks allotted for the question.

Step - 6: Revision before examination and assessment of your preparation

As discussed earlier, you should complete two rounds of revision before your examination. You should go through the entire curriculum again during your first revision. This will facilitate the strengthening of concepts and will also lead to better retention of the various provisions. After you complete your first revision, you should go through the statutory updates given in the RTP relevant for your examination. For assessing your preparation status after first revision, you should attempt solving the questions given in Revision Test Papers (RTP) on your own and then compare your answers with the answers given therein. The questions are an

appropriate mix of amendments based questions, practical problems and theoretical questions. Needless to say, after identifying the mistakes made by you while solving the questions of the RTP, you should adjust your second revision plan appropriately to make time for strengthening those gray areas.

Your second round of revision should ideally start in the last month of the examination. After you finish the revision of the entire curriculum second time, you should once again check your preparation status with the help of Mock Test Paper of the Taxation. You should attempt the Mock Test Paper with sincerity as your performance in the Mock Test Paper will actually give you an insight of your preparation level.

Step - 7: The day before examination

On the day before examination, you should not go into much detail due to time constraints. Do not burn the midnight oil. Have adequate sleep. Just go through summary of each chapter and the treatment of significant issues.

Step - 8: Facing the examination

- (a) *Answer the questions with due emphasis on provisions of the law* - Support your answers/conclusions with proper reasoning. Answers should be based on relevant legal provisions rather than a mere common sense and/or guess work.
- (b) *Quote relevant section numbers* – Quoting section numbers would definitely add value to your answers. However, it is better not to quote than to misquote a section number.
- (c) *Give clear assumptions* - Sometimes, there may be different point of view on procedural law based provisions. As a student, you should state your view/assumption clearly and proceed to answer the question on that basis.
- (d) *Answer in commensuration with the marks carried by the question* - You should determine the length of your answer having regard to the marks allotted to the question. Do not have the misconception that lengthy answers fetch more marks.
- (e) *Do not use short forms* – Use of short forms like CEO, AC, DC should be avoided. Write the full names of the statutes, like, 'Service Tax Rules, 1994' or 'Finance Act, 1994'.
- (f) *First attempt the question which you know best* – This will boost your confidence while attempting the remaining questions and create a positive impression of your level of knowledge on the examiner.
- (g) *Present your answers well* - Underline important points and section references as and when you answer each question. Also, make sure that your handwriting is neat and legible. Answer all parts of a question one after the other. Do not answer different parts of the same question at different places.
- (h) *Follow instructions given on the cover page of answer paper* - Pay heed to the instructions given on the cover page of the answer paper.

To conclude

Last but not the least, remember that studies will not be an arduous task if they are approached with a positive attitude and pursued with interest. If you enjoy your study, your learning will be permanent and profound. A word of caution – do not try to mug up the provisions but understand the underlying concepts. Remember, strong conceptual clarity is the foundation for building a potent knowledge base.

Always bear in mind that your own resolution to succeed is more important than any other. Therefore, give your hundred percent and there will be no looking back.

SYLLABUS

PAPER – 4 : TAXATION

(One paper — Three hours – 100 Marks)

Level of Knowledge: Working knowledge

PART II – INDIRECT TAXES (50 MARKS)

Objective: To develop an understanding of the basic concepts of the different types of indirect taxes and to acquire the ability to analyse the significant provisions of service tax.

1. **Introduction to excise duty, customs duty, central sales tax and VAT – Constitutional aspects, Basic concepts relating to levy, taxable event and related provisions**
2. **Significant provisions of service tax**
 - (i) Constitutional Aspects
 - (ii) Basic Concepts and General Principles
 - (iii) Charge of service tax including negative list of services
 - (iv) Point of taxation of services
 - (v) Exemptions and Abatements
 - (vi) Valuation of taxable services
 - (vii) Invoicing for taxable services
 - (viii) Payment of service tax
 - (ix) Registration
 - (x) Furnishing of returns
 - (xi) CENVAT Credit [Rule 1 -9 of CENVAT Credit Rules, 2004]

Note – If new legislations are enacted in place of the existing legislations the syllabus will accordingly include the corresponding provisions of such new legislations in place of the existing legislations with effect from the date to be notified by the Institute. Students shall not be examined with reference to any particular State VAT Law.

PART II – INDIRECT TAXES

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Basic Concepts of Indirect Taxes

UNIT – 1: INTRODUCTION

Learning objectives

After reading Unit- 1 of this Chapter, you will be able to understand:

- ◆ the concept of tax and the objective for its levy
- ◆ the concept of direct and indirect tax and the differences between the two
- ◆ the basic features of indirect taxes
- ◆ the Constitutional provisions pertaining to levy of taxes
- ◆ what are the principal indirect taxes
- ◆ as to how the indirect taxes are administered in the country.

1.1 Background

In any Welfare State, it is the prime responsibility of the Government to fulfill the increasing developmental needs of the country and its people by way of public expenditure. India, being a developing economy, has been striving to fulfill the obligations of a Welfare State with its limited resources; the primary source of revenue being the levy of taxes. Though the collection of tax is to augment as much revenue as possible to the Government to provide public services, over the years it has been used as an instrument of fiscal policy to stimulate economic growth. Thus, taxes are collected to fulfill the socio-economic objectives of the Government.

What is a tax? A tax may be defined as a "pecuniary burden laid upon individuals or property owners to support the Government, a payment exacted by legislative authority. A tax "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority".

In simple words, tax is nothing but money that people have to pay to the Government, which is used to provide public services.

1.2 Direct and Indirect Taxes

Taxes are broadly classified into direct and indirect taxes.

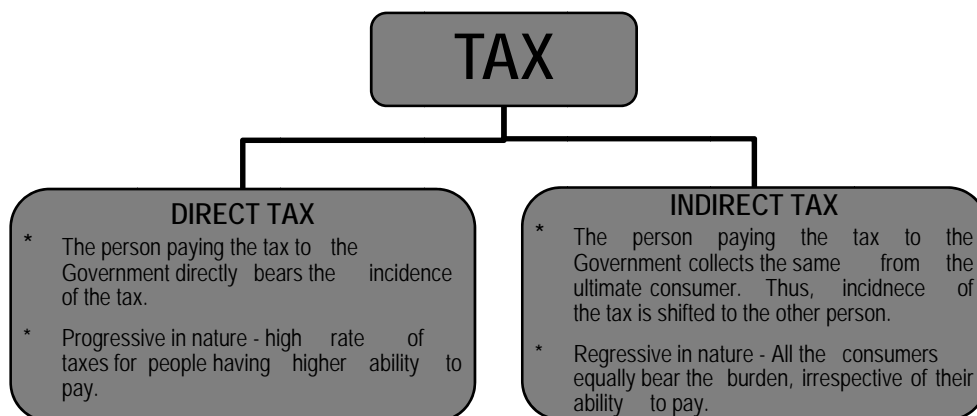
Direct Taxes: A direct tax is a kind of charge, which is imposed directly on the taxpayer and paid directly to the Government by the persons (juristic or natural) on whom it is imposed. A direct tax is one that cannot be shifted by the taxpayer to someone else. The significant direct taxes imposed in India are income tax and wealth tax.

1.2 Indirect Taxes

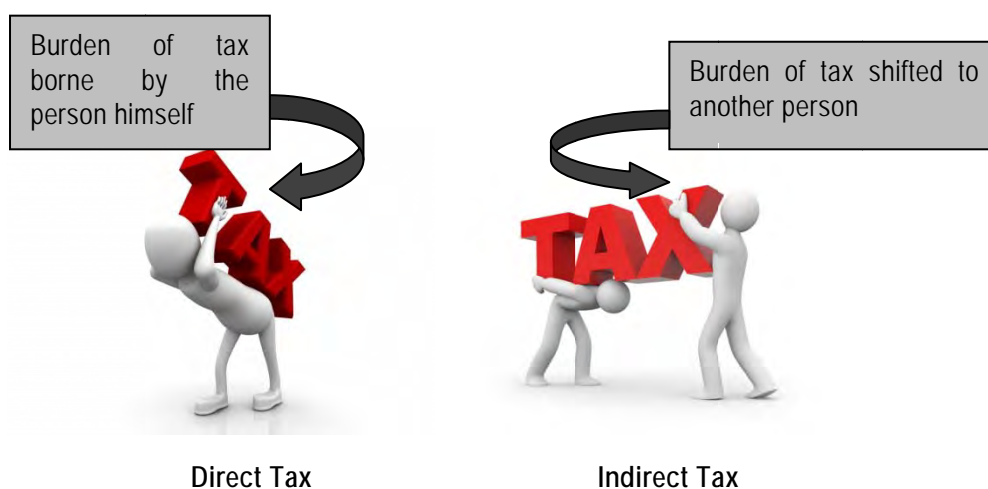
Indirect Taxes: If the taxpayer is just a conduit and at every stage the tax-incidence is passed on till it finally reaches the consumer, who really bears the brunt of it, such tax is indirect tax. An indirect tax is one that can be shifted by the taxpayer to someone else. Its incidence is borne by the consumers who ultimately consume the product or the service, while the immediate liability to pay the tax may fall upon another person such as a manufacturer or provider of service or seller of goods. Also called consumption taxes, they are regressive in nature because they are not based on the principle of ability to pay. All the consumers, including the economically challenged bear the brunt of the indirect taxes equally.

Indirect taxes are levied on consumption, expenditure, privilege, or right but not on income or property. The significant indirect taxes levied in India are excise duty, customs duty, service tax, central sales tax (CST), value added tax (VAT), octroi, entry tax, purchase tax and the like.

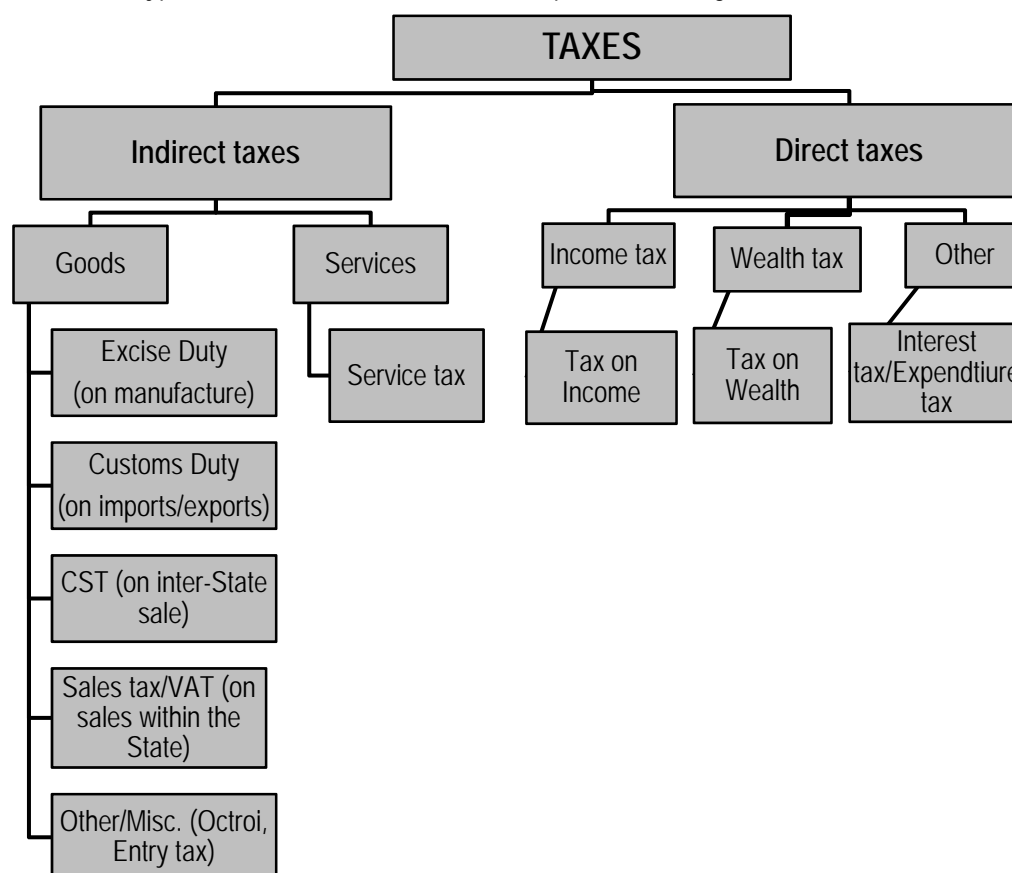
Economists world over agree that direct and indirect taxes are complementary and therefore, a rational tax structure should incorporate in itself both types of taxes.



[Fig. 1]



The different types of direct and indirect taxes are presented in figure 2 below:



[Fig. 2]

1.3 Features of indirect taxes

- (i) **An important source of revenue:** Indirect taxes are a major source of tax revenues for Governments worldwide and continue to grow as more countries move to consumption oriented tax regimes. In India, indirect taxes contribute more than 50% of the total tax revenues of Central and State Governments.
- (ii) **Tax on commodities and services:** It is levied on commodities at the time of manufacture or purchase or sale or import/export thereof. Hence, it is also known as commodity taxation. It is also levied on provision of services.
- (iii) **Shifting of burden:** There is a clear shifting of tax burden in respect of indirect taxes. For example, VAT which is paid by the seller of the goods is recovered from the buyer by including the tax in the cost of the commodity.
- (iv) **No perception of direct pinch:** Since, value of indirect taxes is generally inbuilt in the price of the commodity, most of the time the tax payer pays the same without actually

1.4 Indirect Taxes

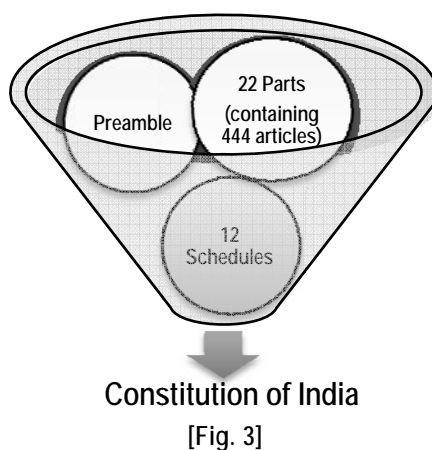
knowing that he is paying tax to the Government. Thus, tax payer does not perceive a direct pinch while paying indirect taxes.

- (v) **Inflationary:** Tax imposed on commodities and services causes an all-round price spiral. In other words, indirect taxation directly affects the prices of commodities and services and leads to inflationary trend.
- (vi) **Wider tax base:** Unlike direct taxes, the indirect taxes have a wide tax base. Majority of the products or services are subject to indirect taxes with low thresholds.
- (vii) **Promotes social welfare:** High taxes are imposed on the consumption of harmful products (also known as 'sin goods') such as alcoholic products, tobacco products etc. This not only checks their consumption but also enables the State to collect substantial revenue.
- (viii) **Regressive in nature:** Generally, the indirect taxes are regressive in nature. The rich and the poor have to pay the same rate of indirect taxes on certain commodities of mass consumption. This may further increase the income disparities between the rich and the poor.

1.4 Constitutional provisions

India has a three-tier federal structure, comprising the Union Government, the State Governments and the Local Government. The power to levy taxes and duties is distributed among the three tiers of Governments, in accordance with the provisions of the Indian Constitution.

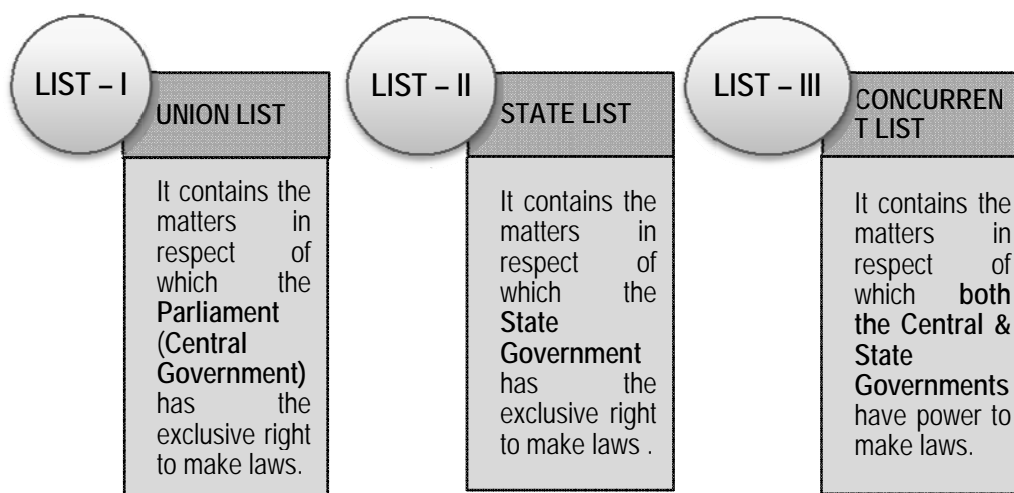
The Constitution of India is the supreme law of India. It consists of a Preamble, 22 parts containing 444 Articles and 12 Schedules.



Power to levy and collect taxes whether, direct or indirect emerges from the Constitution of India. In case any tax law, be it an act, rule, notification or order is not in conformity with the Constitution, it is called *ultra vires* the Constitution and is illegal and void.

Thus, a study of the basic provisions of the Constitution is essential for understanding the genesis of the various taxes being imposed in India. The significant provisions of the Constitution relating to taxation are:

- (i) **Article 265:** Article 265 of the Constitution of India prohibits arbitrary collection of tax. It states that “**no tax shall be levied or collected except by authority of law**”. The term “authority of law” means that tax proposed to be levied must be within the legislative competence of the Legislature imposing the tax.
- (ii) **Article 245:** Part XI of the Constitution deals with relationship between the Union and States. The power for enacting the laws is conferred on the Parliament and on the Legislature of a State by Article 245 of the Constitution. The said Article provides as under:
 - (i) Subject to the provisions of this Constitution, Parliament may make laws for the whole or any part of the territory of India, and the legislature of a State may make laws for the whole or any part of the State.
 - (ii) No law made by the Parliament shall be deemed to be invalid on the ground that it would have extra-territorial operation.
- (iii) **Article 246:** It gives the respective authority to Union and State Governments for levying tax. Whereas Parliament may make laws for the whole of India or any part of the territory of India, the State Legislature may make laws for whole or part of the State.
- (iv) **Seventh Schedule to Article 246:** It contains three lists which enumerate the matters under which the Union and the State Governments have the authority to make laws.



[Fig. 4]

Entries 82 to 92C of List I enumerate the subjects where the Central Government has power to levy taxes. Entries 45 to 63 of List II enumerate the subjects where the State Governments have the power to levy taxes. Parliament has a further power to make any law for any part of

1.6 Indirect Taxes

India not comprised in a State even if such matter is included in the State List.

The table given below enlists the significant direct as well as indirect taxes being levied in India under the various Entries of the Union and State Lists. There is no head of taxation in the Concurrent List (Union and the States have no concurrent power of taxation).

| S. No. | Union List (List I) | State List (List II) |
|--------|--|--|
| (i) | Income tax Entry 82 - Taxes on income other than agricultural income | State Level VAT Entry 54 - Taxes on the sale or purchase of goods (excluding newspapers) except tax on inter-State sale or purchase |
| (ii) | Customs Duties Entry 83 - Duties of customs including export duties | State Excise Duties Entry 51 - Duties of excise on alcoholic liquors for human consumption; opium, Indian hemp and other narcotic drugs and narcotics. The entry does not include duties of excise on medicinal and toilet preparations containing alcohol or opium/Indian hemp/narcotic drugs/narcotics |
| (iii) | Central Excise Duties Entry 84 - Duties of excise on tobacco and other goods manufactured or produced in India except alcoholic liquors for human consumption; opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or opium/Indian hemp/narcotic drugs/narcotics | |
| (iv) | Wealth Tax Entry 86 - Taxes on capital value of assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies | |
| (v) | Central Sales Tax Entry 92A - Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course | |

| S. No. | Union List (List I) | State List (List II) |
|--------|--|----------------------|
| | of inter-State trade or commerce | |
| (vi) | Service Tax Entry 97 - Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists | |
| (vii) | Entry 92C - Tax on services [Amendment passed by the Parliament on 15.1.2004, but yet not made effective] | |

1.5 Principal indirect taxes

The principal central and state level indirect taxes being levied in India along with the relevant statutes are tabulated below:

| Tax | Relevant Statute | Particulars |
|--|---|--|
| Excise Duty [Central Value Added Tax (CENVAT)] | <ul style="list-style-type: none"> Central Excise Act, 1944 Central Excise Tariff Act, 1985 | <p>A tax on the manufacture or production of goods in India imposed by the Central Government.</p> <p><i>Basic General rate: 12%</i></p> |
| Customs Duty | <ul style="list-style-type: none"> Customs Act, 1962 Customs Tariff Act, 1975 | <p>A duty imposed by the Central Government on goods imported into/exported out of India.</p> <p><i>Basic General Rate: 10% + Additional duty of customs (CVD) equivalent to the excise duty levied on like goods produced in India (12%) + Special additional duty of customs @ 4%.</i></p> |
| Service Tax | <ul style="list-style-type: none"> Chapter V and VA of the Finance Act, 1994 | <p>A tax imposed by the Central Government on the services (except the services covered in the negative list of services and exempted services)</p> <p><i>Rate: 12%</i></p> |
| Central Sales Tax | <ul style="list-style-type: none"> Central Sales Tax | A tax on the inter-State sales of |

1.8 Indirect Taxes

| | | |
|-----------------|--|--|
| | Act, 1956 | goods, imposed by the Central Government but appropriated by the originating State. <i>Rate: 2%</i> |
| Value Added Tax | <ul style="list-style-type: none">• VAT Acts of respective State Governments | A tax on the intra-State sales of goods, imposed by the State Governments. <i>Rate generally at 5% and 12.5% /13.5%</i> |

Besides these, there are other indirect taxes like entry tax, luxury tax, entertainment tax etc. levied by the State Governments. Municipal or local authorities also impose taxes like octroi or local area taxes.

In this Chapter you will learn the basic concepts relating to levy, taxable event and other related provisions in respect of central excise duty, customs duty, service tax, central sales tax and value added tax.

1.6 Administration of indirect taxes

The Department of Revenue of the Ministry of Finance exercises control in respect of matters relating to all the direct and indirect taxes through two statutory Boards, namely, the Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC) respectively. Matters relating to the levy and collection of all the direct taxes (income tax, wealth tax etc.) are looked after by CBDT, whereas those relating to levy and collection of central indirect taxes (customs duties, central excise duties, service tax) fall within the purview of CBEC. The two Boards have been constituted under the Central Board of Revenue Act, 1963.

CBEC deals with the tasks of formulation of policy concerning levy and collection of customs and central excise duties and service tax, prevention of smuggling and administration of matters relating to customs, central excise, narcotics to the extent under CBEC's purview and service tax. The Board is the administrative authority for its subordinate organizations, including Custom Houses, Central Excise and Service Tax Commissionerates.

The State level indirect taxes are administered by Commercial Tax Departments of the respective States.

UNIT – 2: CENTRAL EXCISE DUTY

Learning objectives

After reading Unit- 2 of this Chapter, you will be able to understand:

- ◆ the concept of excise duty
- ◆ the Constitutional provisions relating to levy of excise duty
- ◆ the different types of excise duties
- ◆ as to what are the different sources of central excise law
- ◆ the various provisions relating to levy of duty namely, application of excise law, taxable event and charge of excise duty
- ◆ the difference between goods and excisable goods
- ◆ concept of manufacture and deemed manufacture
- ◆ as to who is a manufacturer
- ◆ the provisions relating to collection of duty
- ◆ the concepts relating to classification of goods
- ◆ as to how the excisable goods are valued and what are the different modes of valuing the excisable goods under the central excise law.

Apart from the above, after you finish reading this Unit, you will also get a fair idea of some of the significant procedures under excise law, namely SSI exemption, registration, payment of duty and filing of returns.

2.1 What is excise duty?

Excise is derived from the Latin word “**Excisum/Excidere** which means to cut out”.

The duty of excise is levied on a manufacturer or producer in respect of the commodities produced or manufactured by him. It is a tax upon manufacture of goods and not upon sales or proceeds of sale of goods.

‘Duty of excise’ has been renamed as Central Value Added Tax (CENVAT). **CENVAT includes ‘duty’, ‘duties’ ‘duty of excise’ or ‘duties of excise’.**

Although excise started as a pure duty on manufacturing activity, over a period of time it has included deemed manufacture and became a value added tax. The changed nomenclature (CENVAT) indicates the same.

2.2 Constitutional provisions

Entry 84 of the **Union List of the Seventh Schedule** to Article 246 of Constitution of India provides as under:

1.10 Indirect Taxes

Duties of excise on tobacco and other goods manufactured or produced in India **except:**

- (a) alcoholic liquors for human consumption
- (b) opium, Indian hemp and other narcotic drugs and narcotics; but

including

medicinal and toilet preparations containing alcohol, or any substance stated before.

Example: Medical syrups for cold and cough contain a small portion of alcohol. Even though it contains alcohol, it being a medicine will come under Entry 84 of Union List 1.

Excise duty on alcoholic liquors for human consumption, opium, Indian hemp and other narcotic drugs and narcotics is a State subject i.e, State Government levies excise duty on such products.

2.3 Types of excise duties

The following types of duties are levied under the excise law and through provisions of other Acts from time to time:

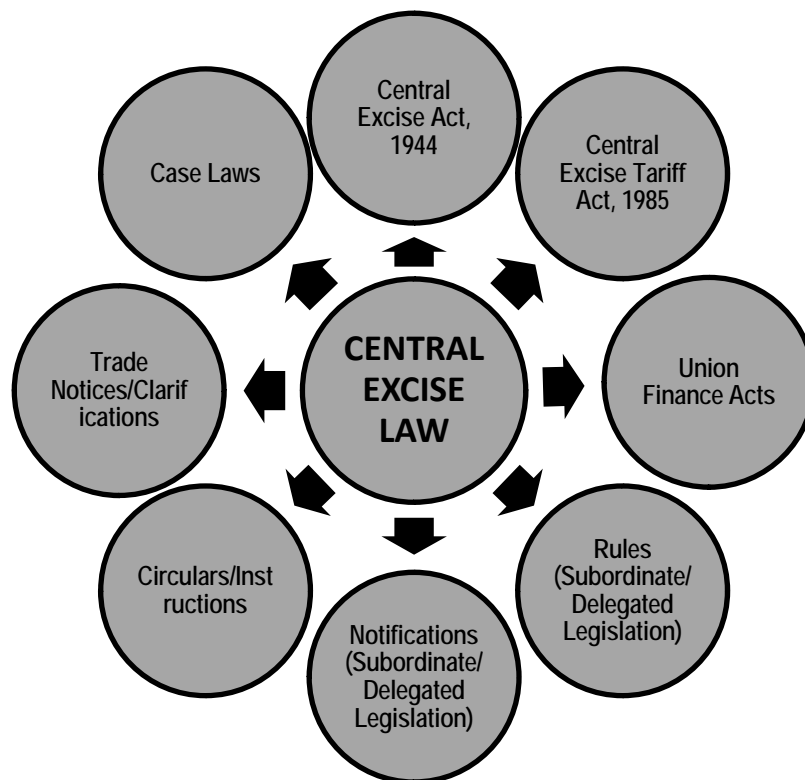
- (i) **Basic Excise Duty:** This duty, also known as CENVAT, is levied under section 3(1)(a) of Central Excise Act. It is levied at the rates specified in First Schedule to the Central Excise Tariff Act, read with exemption notifications, if any. Currently, the general rate of excise duty on non-petroleum products is 12%. This duty is applicable to majority of the excisable goods.
- (ii) **Special Excise Duty:** Special duty of excise is levied under 3(1)(b) of the Central Excise Act. It is levied on the commodities covered in second schedule (e.g. pan masala, cars) to the Central Excise Act, at the rates mentioned therein. However, w.e.f. 01.03.2006 all goods falling in the second schedule have been exempted from the special excise duty.
- (iii) **Additional Duty of Excise (Textile and Textile Articles) [AED(TTA)]:** This duty is leviable under section 3 of the Additional Duties of Excise (Textiles and Textile Articles) Act, 1978. This Act provides for the levy and collection of additional duties of excise on certain textile and textile articles. However, w.e.f. 09.07.2004, all goods which were liable to AED (TTA) have been exempted from such duty.
- (iv) **Additional Duty of Excise (Goods of Special Importance) [AED (GSI)]:** It is levied under Additional Duties of Excise (Goods of Special Importance) Act, 1957 on the specified goods mentioned in its First Schedule. This duty is levied in lieu of sales tax and shared between Central and State Governments. However, w.e.f. 01.03.2006, all goods which were liable to AED (GSI) have been exempted from such duty.
- (v) **National Calamity Contingent Duty (NCCD):** It is imposed vide section 136 of the Finance Act, 2001 on pan masala, branded chewing tobacco, cigarettes, domestic crude oil and mobile phones.
- (vi) **Additional Duty of Excise:** It is imposed by way of surcharge on pan masala and certain specified tobacco products vide section 85 of the Finance Act, 2005.

(vii) **Education Cess:** It is levied on excisable goods manufactured in India @ 2% of the aggregate duties of excise levied on such goods.

(viii) **Secondary and Higher Education cess:** It is levied on excisable goods manufactured in India @ 1% of the aggregate duties of excise (excluding education cess) leviable on such goods.

2.4 Sources of central excise law

Central Excise Law is a combined study of -



[Fig. 5]

(i) **Central Excise Act, 1944:** The Central Excise Act, 1944 (hereinafter referred to as the 'Act' in this Unit) contains the basic provisions relating to the levy of excise duty. It comprises of Chapters I to VII.

(ii) **Central Excise Tariff Act, 1985:** The Central Excise Tariff which was originally a schedule to the Central Excise Act, 1944 was de-linked from it and the Central Excise Tariff, Act 1985 containing the Tariff Schedule was enacted, based on the international product coding system called Harmonised System of Nomenclature (H.S.N.). The Schedules to the Act enlist all the excisable goods and provide for the corresponding rates of excise duty chargeable on the same.

(iii) Annual Union Finance Acts: Every year, the Finance Minister of the Government of India presents the Union Budget to the Parliament. Part A of the Budget Speech contains the proposed policies of the Government in fiscal areas. Part B of the Budget Speech contains the detailed tax proposals. In order to implement the above proposals, the Finance Bill is introduced in the Parliament. Once the Finance Bill is approved by the Parliament and gets the assent of the President, it becomes the Finance Act.

The annual Union Finance Acts are one of the most significant ways through which the Government makes amendments to the central tax acts like the Central Excise Act and Central Excise Tariff Act.

(iv) Rules: Rules are framed by the Central Government for carrying out the provisions of the Act. Rules cannot override the provisions contained in the Act. Rules should be read with the statutory provisions contained in the Act. The following significant rules have been issued under the Central Excise Act, 1944:

- **Central Excise Rules, 2002:** These Rules contain the procedure for the assessment and collection of duty including other procedures like manner of payment of duty, registration, maintenance of records, invoicing, rebate of duty, export without payment of duty etc.
- **Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000:** These rules have been framed to prescribe valuation methods when transaction value cannot be determined under Section 4 of the Central Excise Act, 1944.
- **CENVAT Credit Rules, 2004:** These rules extend the credit of excise duty and service tax across goods and services. They provide for the manner of availing the credit and the utilization thereof.

Besides above, other rules namely, Central Excise (Appeal) Rules, 2001, Central Excise (Advance Rulings) Rules, 2002, Central Excise (Settlement of Cases) Rules, 2007, Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001, Central Excise (Compounding of Offences) Rules 2005, Central Excise (Determination of Retail Sale Price of Excisable Goods) Rules 2008 have also been notified to carry out the purposes of the Central Excise Act, 1944¹.

(v) Notifications: Notifications are issued by the Central Government or the Central Board of Excise and Customs (CBEC) in terms of the power given under the Act or the Rules. Notifications are issued to provide rules relating to excise duty, make amendments therein, provide or withdraw exemptions from excise duty or deal with any other matter which the Central Government may think would facilitate the governance of excise duty.

(vi) Circulars/Instructions: The Central Board of Excise and Customs issues departmental circulars or instruction letters from time to time for the purpose of ensuring uniformity in the classification of excisable goods or with respect to levy of duty of excise on goods. These circulars/instructions should be in conformity with the Act, Rules and Notifications. The

¹ All such rules will be discussed at the Final Level. However, CENVAT Credit Rules, 2004, to the extent covered in syllabus have been discussed in Chapter-7 CENVAT Credit.

circulars are binding on the Department but not binding on the assessee and the Supreme Court, High Court or the Tribunal.

(vii) Trade Notices/Clarifications: Trade notices are issued by the Departmental authorities for trade facilitation and clarification purposes. They are binding on the departmental officers concerned. Authorities cannot take one stand in one State and another stand in another State. Trade notice disseminate the contents of the notifications and circulars/letters, define their jurisdiction; identify the banks in which excise duty can be deposited etc.

(viii) Case Laws: It is not possible for the Parliament to conceive and provide for all possible issues that may arise in the implementation of any Act. Hence, the judiciary hears the disputes between the assessee and the Department and gives decisions on various issues. The Supreme Court is the Apex Court of the country and the law laid down by the Supreme Court is the law of the land. The decisions given by various High Courts apply in the respective States in which such High Courts have jurisdiction. The study of case laws is very essential as the case laws facilitate in interpreting the provisions of the Act and comprehending the real intention of the law makers. In fact, in India the tax laws are perceived to be of very complex nature and thus, role of the judiciary becomes all the more substantial as only the judiciary has the mandate of interpreting such intricate provisions of law.

2.5 Levy of duty

(1) Application of the central excise law: The Central Excise Act applies to the whole of India. Though originally the Act did not apply to the State of Jammu and Kashmir, its application was extended to the same vide the enactment of Taxation Laws (Extension to Jammu & Kashmir) Act, 1954.

It also extends to designated areas in the Continental Shelf and Exclusive Economic Zone of India (EEZ). The EEZ extends upto 200 nautical miles inside the sea from base line.

Therefore, goods manufactured in Indian landmass as also in the designated areas in EEZ will be liable to excise duty.

The Central Excise Tariff Act also applies to whole of India and extends to the designated areas in the Continental Shelf and Exclusive Economic Zone of India (EEZ).

(2) TAXABLE EVENT: Taxable event is a event or transaction that results in a tax consequence for the party who executes the event. For example, the taxable event for levy of state level VAT is sale of products i.e., whenever any sale transaction is occasioned, sales tax liability would arise. Taxable event is the event which triggers the levy of tax.

The taxable event for levy of excise duty is manufacture – only when manufacture takes place, excise duty liability arises. However, all manufacturing processes do not attract levy of excise duty unless some basic conditions are met.

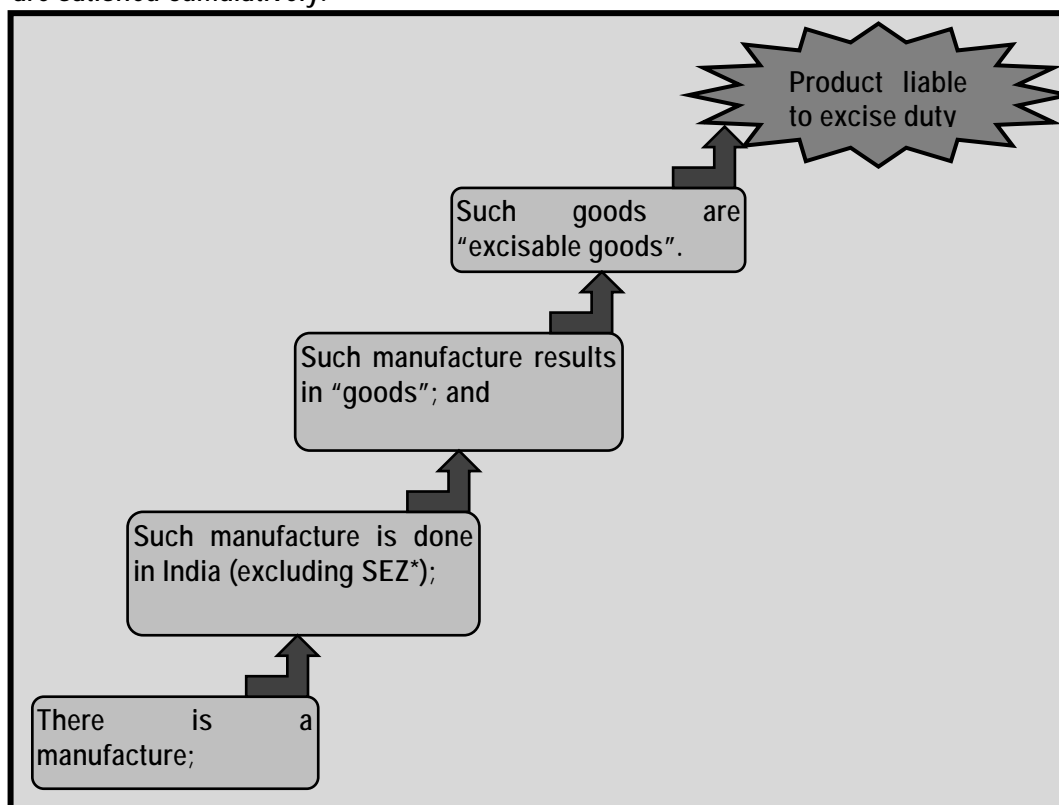
Excise duty is not concerned with ownership or sale. Liability under excise law is event based (based on manufacture) and does not depend upon whether the goods are sold or captively consumed.

Note: Though the levy of excise duty arises on manufacture but the same is collected on

removal of goods from the factory [Collection of duty has been dealt in detail in the subsequent pages of this Unit].

(3) **Charge of excise duty:** Section 3 of the Act is the charging section which provides for levy of excise duty. The provisions of section 3 are discussed below:

(i) **Basic conditions for levy of duty:** Excise duty is leviable when the following four are satisfied cumulatively:



[Fig. 6]

**A Special Economic Zone (SEZ) is a geographically bound zone where the economic laws relating to export and import are more liberal as compared to other parts of the country. Goods manufactured in Special Economic Zones are not leviable to excise duty. SEZ is considered to be a place outside India for all tax purpose.*

(ii) **Government goods also liable to excise duty:** There is no distinction between excisable goods produced by the Government and those produced by others, with regard to payment of excise duty. Excise duty is payable on all excisable goods, other than salt, manufactured in India by or on behalf of the Government (both Central and State) also.

(iii) **Goods manufactured by 100% EOU and brought to DTA liable to excise duty equal to customs duty:** Hundred percent Export Oriented Undertakings are set up to promote exports. They generally export whole of the goods manufactured by them and such exports are exempt

from duty. However, sometimes they may sell their goods in India also (known as Domestic Tariff Area). When EOU's sell their goods in DTA, the goods become liable to excise duty.

Excise duty leviable in such a case is computed as follows:

Excise duty = Total customs duties leviable under the Customs Act/other applicable law on like goods produced/manufactured outside India, if imported into India.

Valuation as per customs law: The value of such goods shall be determined in accordance with the provisions of the Customs Act, 1962 if the duty to be levied is based on the value of such goods (*ad valorem*).

Highest rate to be taken in case of different rates: Where in respect of any such like goods, customs duty is leviable at different rates, then, highest of those rates shall be taken.

Unless the four basic conditions as set out in section 3 for levy are satisfied [Refer point (i)], central excise duty cannot be levied. Thus, it is very important to understand / interpret each of the conditions in detail to appreciate the implications. Each of the conditions is discussed in subsequent pages of this Unit.

2.6 Goods and Excisable Goods

(1) Goods: Explanation to section 2(d) of the Act provides that "goods includes any article, material or substance which is being capable of brought and sold for a consideration and such goods shall be deemed to be marketable". Section 2(d) defines excisable goods. Though the explanation to section 2(d) of the Act sets out as to what are included within the meaning of goods, the concept of goods has been more elaborately defined/explained in other laws/case laws as under:

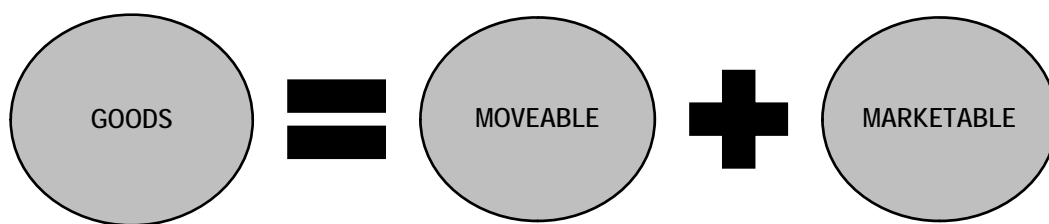
(i) Article 366(12) of the Constitution of India: "Goods include all materials, commodities and articles".

(ii) Sale of Goods Act, 1930: Section 2(7) defines goods to mean "every kind of movable property other than actionable claims and money; and includes stocks and shares, growing crops, grass and things attached to and forming part of the land which are agreed to be severed before sale or under the contract of sale".

Thus, immovable property cannot be goods but any movable property whether visible, tangible, corporeal or not will constitute goods. Goods can be tangible like computer, machinery, pen, pencil etc. as also intangible like drawings, designs, software stored on a media. Similarly, electricity is also goods.

(iii) Judicial View: The Supreme Court in the case of *U.O.I. v. DCM 1997(1) E.L.T. 1199* has held that in order to be goods the articles must be capable of coming to the market to be bought and sold. Therefore, to be called goods, the items must be moveable and marketable.

From the above, two fundamental aspects of the term "goods" arise that they should be (a) 'moveable' and (b) 'marketable'.



[Fig. 7]

(a) **Goods must be Moveable:** To be called goods, the articles must be something, which can ordinarily come or can be brought to the market to be bought and sold. As opposed to moveable goods, immovable property cannot be brought to the market to be sold. Immoveable property includes land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth. **Thus, excise duty cannot be levied on immovable property.**

Example: Construction of roads is not liable to excise duty as roads are not goods. However, manufacture of car, truck etc. will attract excise duty as they are goods.

(b) **Goods must be Marketable:** Unless the goods are capable of being marketed, they cannot be charged to duty. As per Explanation to section 2(d), goods includes any article, material or substance which is being capable of brought and sold for a consideration and such goods shall be deemed to be marketable. Thus, the only condition required for a product to be marketable is its capability of being put into the market for sale.

The following points merit consideration in this regard:

- **Actual sale is not necessary:** Actual sale is not necessary in determining excisability of a product; its capability of being brought and sold for a consideration is sufficient to render it marketable. The fact that goods are not actually marketed is of no relevance. It is also not necessary that goods in question should be generally available in the market.
- **Even one purchaser enough:** Marketability does not depend upon the number of purchasers nor is the market confined to territorial limits of India.
- **Burden of proof on Department:** Marketability is a question of fact to be decided on the basis of the facts of each case. It is the onus of the Department to produce evidence of marketability.
- **Goods of short-shelf life:** Goods of short-shelf life, say one or two days will be deemed to be marketable only if they are capable of being brought and sold during that period.

(2) **Excisable Goods:** Before we examine the question of what amounts to manufacture, it must be understood that unless the goods that are manufactured are excisable goods, there will be no question of levying excise duty.

Section 2(d) of the Act defines 'excisable goods'. The definition can be divided into three parts:

Excisable goods means-

- goods which are specified in the First Schedule and the Second Schedule to the Central Excise Tariff Act, 1985
- as being subject to a duty of excise and

- includes salt.

Explanation: Goods includes any article, material or substance which is being capable of brought and sold for a consideration and such goods shall be deemed to be marketable.

Thus, for becoming excisable goods, goods must not only be specified in the Tariff but must also be subject to a duty of excise.

The following points merit consideration in this regard:

- **Nil rate is a rate of duty:** Nil rate is also a rate of excise duty. Therefore, goods specified in the Tariff as being subject to Nil rate of duty are also excisable goods.

Example: Bamboos, Common salt, Rock salt are excisable goods liable to 'NIL' rate of duty.

- **Exempted goods:** Exempted goods are goods which have been exempted from payment of duty by way of an exemption notification. Exempted goods are excisable goods but no duty is payable on them in view of 100% exemption granted by way of notification.

The excise duty liability in relation to goods and excisable goods has been explained with the help of a flow diagram given at page no. 1.19.

2.7 Manufacture

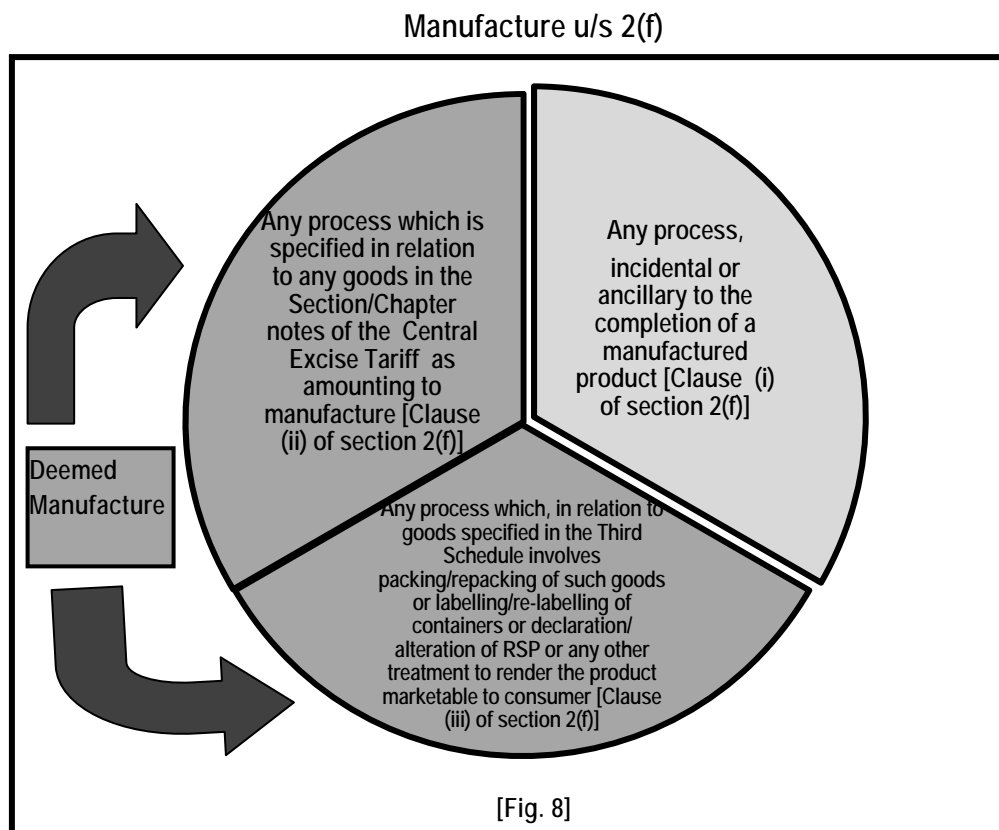
(1) Concept of manufacture: Manufacture or production of excisable goods in India is the taxable event for levy of central excise duty. Section 2(f) of the Act defines the term "manufacture" in an inclusive manner as follows:

Manufacture includes any process,

- (i) incidental or ancillary to the completion of a manufactured product;
- (ii) which is specified in relation to any goods in the Section or Chapter Notes of the Schedule to the Central Excise Tariff Act, 1985 as amounting to manufacture; or
- (iii) which, in relation to goods specified in the Third Schedule, involves packing or repacking of such goods in a unit container or labelling or re-labelling of containers including the declaration or alteration of retail sale price on it or adoption of any other treatment on the goods to render the product marketable to consumer

and the term manufacturer shall be construed accordingly and shall include not only a person who employs hired labour in the production or manufacture of excisable goods, but also any person who engages in their production or manufacture on his own account.

ANALYSIS:



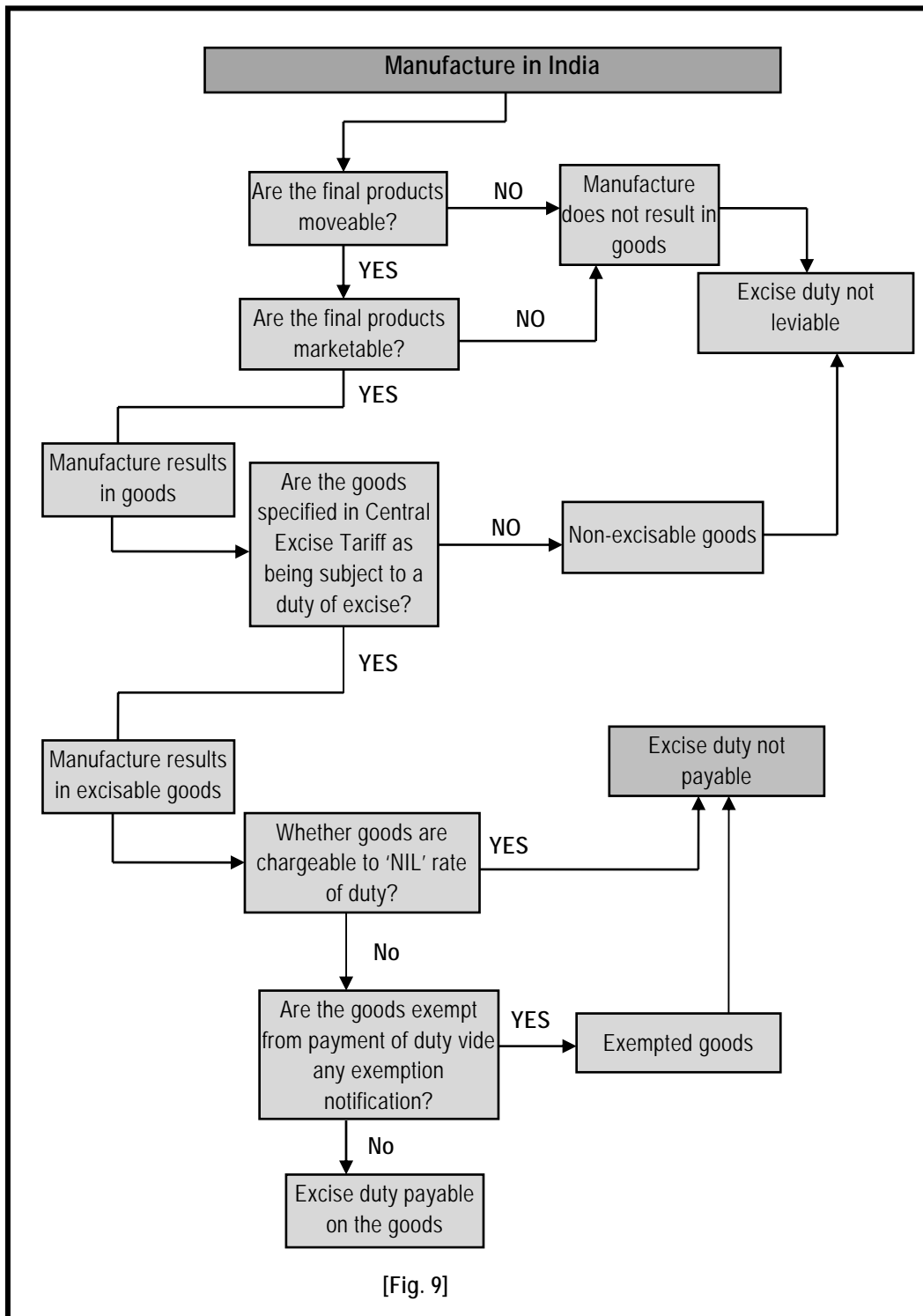
Since the definition of manufacture is an inclusive one and does not spell out or enumerate the activities covered therein, the understanding of the term has been arrived at on the basis of the numerous legal decisions rendered in this regard.

The most commonly used test for ascertaining as to whether "manufacture" for the purpose of attracting central excise duty has taken place was evolved by the Supreme Court in the case of *Delhi Cloth and General Mills 1977 (1) ELT (J 199)*. The Court cited the following passage from an American judgement relating to manufacture:

"Manufacture implies a change, but every change is not manufacture and yet change of an article is the result of treatment, labour and manipulation. But something is necessary and there must be transformation; a new and different article must emerge having a distinctive name and character or use".

This famous paragraph is now the basis for determining whether or not an activity or process amounts to manufacture.

Therefore, the activity or process in order to amount to "manufacture" must lead to emergence of a new commercial product, different from the one with which the process started. In other words, it must be an article with different name, character or use.



1.20 Indirect Taxes

Burden of proof on department: Burden to prove that an activity/process amounts to manufacture is on the department.

Examples of processes amounting to manufacture:

- (1) Obtaining sugar from sugarcane
- (2) Making furniture from wood
- (3) Rolling of tobacco to make biris
- (4) Conversion of fruit pulp to ready made fruit drink
- (5) Cutting, hemming and stitching of running cloth to make bed sheets, bed spreads and table cloths
- (6) Roasting, salting and spicing of peanuts/cashew-nuts/almonds
- (7) Obtaining oil or oil cake from oil seeds (mustard oil or mustard cake from mustard seeds)
- (8) Making of wheat flour from wheat

Examples of processes not amounting to manufacture:

- (1) Burning in boiler of coal to obtain cinder
- (2) Stirring of cream to obtain butter
- (3) Upgradation of computer system by increasing the storage capacity
- (4) Painting of goods
- (5) Cutting of wood into small pieces
- (6) Chilling of water

(2) **DEEMED MANUFACTURE:** Clauses (ii) and (iii) of the definition of manufacture as provided in section 2(f) of the Act are termed as 'deemed manufacture'. The aforesaid definition gives a wider meaning to the expression "manufacture" as several processes which would not ordinarily be understood as amounting to manufacture are specifically included therein.

Thus, a process which simply changes the form or size of the same article or substance would not ordinarily amount to manufacture and no excise duty would be payable unless it is deemed to be manufacture in either of the two following ways:

- The process is specified in the Section or Chapter Notes of the Schedule to the Central Excise Tariff as amounting to manufacture; or
- The goods are specified in the Third Schedule to the Act and the process involves packing or repacking of such goods in a unit container, labelling or re-labelling of containers including declaration or alteration of retail sales price on it or adoption of any other treatment on the goods to render the product marketable to the consumer.

The Third Schedule to the Act covers the goods which are assessed on the basis of retail sale price. Valuation of excisable goods based on retail sale price has been discussed in subsequent pages of this Unit.

Examples of deemed manufacture:

- (1) In relation to iron and steel covered in Chapter 72, Chapter Note 5 provides that the process of galvanization shall amount to manufacture.
- (2) In relation to audio or video tapes/CDs etc. falling under heading 8523 of Chapter 85, Chapter Note 10 provides that recording of sound or other phenomenon shall amount to manufacture.
- (3) In relation to aluminium foils falling under heading 7607 of Chapter 76, Chapter Note 3 provides that process of cutting, slitting and printing of aluminium foils amount to manufacture.

Illustration 1: *Indicate whether the following activities will be liable to central excise duty?*

- (1) *Manufacture of alcohol and wine.*
- (2) *Manufacture of medicinal and cosmetic products containing alcohol.*
- (3) *Manufacture of excisable goods in a factory located in Jammu & Kashmir.*
- (4) *Production of excisable goods in notified designated areas at 210 nautical miles from the Indian landmass.*
- (5) *Production of excisable goods in a factory located in SEZ.*
- (6) *Manufacture of salt by the Central Government.*
- (7) *Repairing, reconditioning or remaking.*
- (8) *Manufacture of parts used for repair or replacement during warranty period.*
- (9) *Labeling or re-labeling of unit containers of chocolate. Chocolate is specified in Third Schedule to Central Excise Act, 1944.*

Solution:

- (1) *No. Entry 84 of the Union List of the Seventh Schedule specifically excludes alcoholic liquors for human consumption. Since, Entry 54 of the State List covers duties of excise on alcoholic liquors for human consumption, it may be liable to State excise duty.*
- (2) *Yes. Medicinal and cosmetic products containing alcohol are covered by Entry 84 of the Union List.*
- (3) *Yes. The central excise law extends to Jammu and Kashmir.*
- (4) *No. The central excise law extends to the notified designated areas in EEZ upto 200 nautical miles from the Indian landmass.*
- (5) *No. The central excise law does not apply to goods manufactured in SEZ.*
- (6) *No. Though there is no distinction between excisable goods produced by the Government and those produced by others, salt manufactured by Government is not leviable to excise duty.*
- (7) *No, since repairing, reconditioning or remaking does not result in to emergence of a new*

product.

- (8) *Yes. Excise duty is a levy on manufacture. Therefore, it is of no importance as to whether the manufactured goods are sold, captively consumed, distributed as free sample or used for free repair / replacement during warranty period etc.*
- (9) *Yes. Labeling or re-labeling of unit containers of the goods specified in Third Schedule to the Central Excise Act is deemed manufacture. Since chocolate is covered under Third Schedule, the labeling or re-labeling of its container will amount to manufacture.*

(3) Some special aspects

(i) Captive consumption: Captive consumption in the context of excise law means utilisation of goods produced or manufactured within the factory of production. The goods internally consumed to manufacture the final product are termed as intermediate goods.

Example: Rubber is used in manufacturing of soles and such soles are further used in manufacture of chappals. Here, soles are intermediate goods and their consumption within the factory for manufacture of chappals is captive consumption.

Levy of excise duty: The intermediate goods will be chargeable to duty if they arise in the course of manufacture/production, are moveable and marketable in such intermediate stage, listed in the Tariff, and are subject to duty of excise in the Tariff.

However, since paying duty on all captive consumption will cause inconvenience to manufacturers, exemptions have been given in many cases. If duty is payable on final product, excise duty is not payable on intermediate product used in manufacture of such final products.

(ii) Assembly *vis a vis* manufacture: Assembly is a process of putting together a number of items or parts of an item to make a product or an item. From a general point of view, assembly would not amount to manufacture in as much as an already manufactured item may be put in a readily usable form. However, if the assembly results in new commercial commodity with a distinct name, character and use, then it would amount to manufacture.

Example: Assembly of computers from duty paid bought out parts amounts to manufacture.

(iii) Dutiability of site-related activities: The goods manufactured at site will be liable to duty if they have a new identity, character and use, distinct from the inputs/ components that have gone into its production. Further, such resultant goods should be specified in the Central Excise Tariff as excisable goods besides being marketable i.e. they can be taken to the market and sold (even if they are not actually sold). The goods should not be immovable.

Examples:

- (1) Lifts and escalators installed in buildings and permanently fitted into the civil structure cannot be considered to be excisable goods and hence are not liable to duty.
- (2) Group of machines combined to constitute a new machine having own identity/marketability will be dutiable if assembled at site and fixed to earth only for purpose of ensuring vibration free movement.

(iv) **Dutiability of waste and scrap:** Waste/scrap can be 'excisable goods' if they are known in commercial parlance and are marketable. Further, the waste and scrap will not be 'excisable goods' unless they are specified in Central Excise Tariff. Thus, if a particular waste/scrap is not mentioned in Tariff, it may be 'goods' but not 'excisable goods'.

It is important to note here that as the excise duty is leviable on manufacture, the waste and scrap actually generated in the course of manufacture alone is chargeable to duty and the waste and scrap generated without any process is not liable to excise duty.

Waste of exempted goods: Waste of exempted goods has been exempted from payment of excise duty.

Examples:

- (1) Aluminium/zinc dross which is termed as waste/residue/refuse is chargeable to excise duty as it is an excisable goods arising during the course of manufacture and is capable of being sold for consideration.
- (2) Waste or scrap arising from repair of machinery is not a manufactured product as it doesn't arise during manufacture of final product. Therefore, it will not be liable to duty.

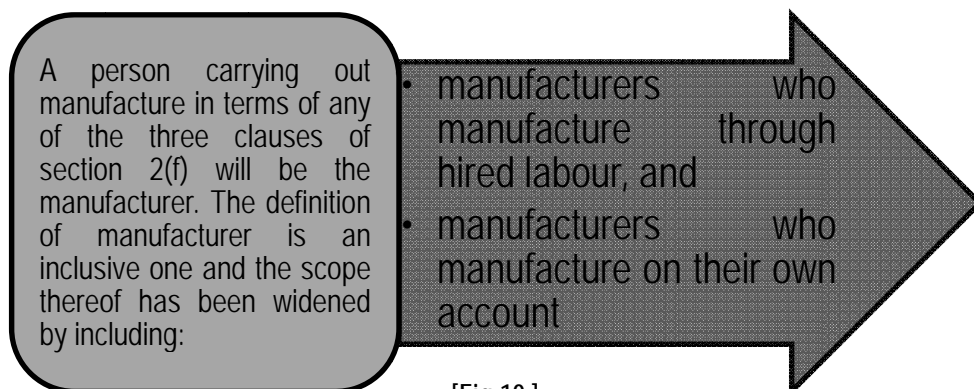
2.8 Manufacturer

The term '**manufacturer**' has been defined in the definition of the term 'manufacture'.

As per section 2(f) of the Act, manufacture includes any process,and the term **manufacturer** shall be construed accordingly

- and shall include not only a person who employs hired labour in the production or manufacture of excisable goods,
- but also any person who engages in their production or manufacture on his own account.

ANALYSIS:



[Fig.10]

It is very important to understand as to who would be the manufacturer as it is the manufacturer, who is required to discharge the duty liability on the excisable goods in most of the cases.

Manufacturer may be understood as any person who is the creator, initiator and architect of the activities and the processes, which bring into existence a new and identifiable product/goods in the market. Thus, a manufacturer is the one who undertakes natural manufacturing activity or who undertakes the processes defined as 'deemed manufacture'.

Some special aspects:

(i) **Raw material supplier *vis a vis* manufacturer:** The person carrying out the actual manufacturing process is the manufacturer even if the raw material is supplied by someone else and the goods have been manufactured as per his specifications. Merely by supplying the raw material, the supplier thereof cannot be construed as the manufacturer. Therefore, it is not relevant as to whether the raw material belongs to the manufacturer or not.

Example: M/s. Papadwala supplies raw material to several household ladies to make papads. These ladies make papads at their homes and supply the same to M/s. Papadwala. M/s. Papadwala does not supervise the ladies. M/s. Papadwala is only the raw material supplier and not the manufacturer as it does not exercise control and supervision over the ladies making papads. The ladies making papads are the manufacturers in this case.

(ii) **Brand name owner *vis a vis* manufacturer:** Many a times, large manufacturers do not manufacture goods on their own but get their goods manufactured from others under their brand name. They usually exercise quality control and may also supply the design. In such cases, these large manufacturers will not be the manufacturer but the units actually manufacturing the product will be the manufacturer.

Example: If Usha Fans gets its fans made from other fan making units under its brand name 'USHA', Usha Fans will not be the manufacturer in this case. The other fan making units who actually make the fans will be the manufacturer under central excise.

Ownership of raw material is not relevant to determine who the manufacturer is. In both the above cases, the contracts are on a principal to principal basis. However, if the relationship between the raw material supplier/brand name owner and the job-worker is that of a principal and agent, the raw material supplier/brand name owner will be the manufacturer. It may be noted that a person supplying the raw material/brand name owner cannot be considered as hiring the job worker if he does not supervise and control the activities of the job worker. However, if the manufacturer is a dummy or fake unit, then the raw material supplier or the brand name owner will be deemed to be the actual manufacturer.

2.9 Collection of duty

(1) **When is duty liable to be paid?:** As learned before, the taxable event for the levy of excise duty is manufacture, but the collection thereof is postponed to the stage of removal. Therefore, excisable goods cannot leave the factory of production unless excise duty thereon has been paid. However, excisable goods can be removed from the factory and stored in a warehouse without payment of duty. Excise duty, in such a case, becomes payable when the excisable goods are removed from the warehouse.

(2) **On which type of removals is the duty liable to be paid?:** As per rule 4 of the Central Excise Rules, 2002, excisable goods cannot be removed from the place of manufacture or

from warehouse - when the goods are stored in warehouse - **without payment of duty** whether for

- ✓ consumption, or
- ✓ export, or
- ✓ manufacture of any other commodity in or outside the place of manufacture

until the excise duty leviable thereon has been paid in the prescribe manner.

(3) Who is liable to pay duty?: The liability to pay excise duty has been casted on every person-

- who produces or manufactures any excisable goods, or
- who stores such goods in a warehouse

Exception

Procurer of molasses liable to pay excise duty on molasses: Where molasses are produced in a Khandsari sugar factory, the person who procures such molasses (not the person who produces the same) for use in the manufacture of any commodity has to pay the duty leviable on such molasses as if the molasses had been produced by the procurer.



[Fig. 11]

(4) What is the relevant date for determining the rate of duty?: Rule 5 of the Central Excise Rules, 2002 contains the provisions for determining the relevant date. The rate of duty and the tariff value prescribed under section 3(2) of the Act prevalent on the relevant date are used for the purpose of computing the amount of excise duty payable. Valuation of excisable goods based on tariff value is discussed in subsequent pages of this Unit. Provisions of rule 4 and 5 have been tabulated as under:

| Particulars | Person liable to pay excise duty | Event for duty payment | Relevant date |
|---|----------------------------------|-----------------------------------|--|
| 1. Excisable goods (other than khandsari molasses) produced and stored in the factory of the manufacturer | Manufacturer | Removal of goods from the factory | Date of removal of such goods from the factory |

1.26 Indirect Taxes

| | | | |
|--|---|--|--|
| 2. Khandsari molasses produced and stored in the factory of the manufacturer | Procurer of the khandsari molasses | Receipt of such molasses by the procurer | Date of receipt of such molasses in the factory of the procurer of such molasses |
| 3. Excisable goods produced and cleared for captive consumption in the factory of production | Manufacturer | Issuance of goods for further production | Date on which the goods are issued for such use |
| 4. Excisable goods produced in the factory and stored in a warehouse without payment of duty | Person who stores such goods in the warehouse | Removal of goods from the warehouse | Date of removal of goods from the warehouse |

Some special aspects:

(i) **Change in rate of duty between the date of manufacture and the date of removal:** Sometimes it may happen that the rate of duty which was prevalent when the goods were manufactured undergoes a change when the goods are removed from the factory. This generally happens when the rate of duty is increased / decreased in the annual Union Budget.

Example: Excise duty rate was increased from 10% to 12% with effect from 17.03.2012. Thus, in case of excisable goods manufactured during the month of February and cleared on 20.03.2012, the rate of duty was 10% when the same were manufactured but was increased to 12% when the same were removed from the factory.

It needs to be remembered that where the goods were excisable at the time of manufacture, duty will be leviable at the rate prevalent on the date of removal.

Thus, in the above example, excise duty will be paid @ 12%.

(ii) **Goods becoming excisable/dutiable post manufacture but before removal:** There can be situations when goods which are manufactured at the period in time when they were either not chargeable to duty or were exempted from duty get included in Tariff or become dutiable on account of withdrawal of the exemption subsequent to manufacture but before removal of such goods.

The following points need to be considered in this regard:

- Non-excisable goods (goods not covered in the Central Excise Tariff or goods with blank rate column) will not be chargeable to duty even though subsequent to manufacture but before removal such goods are bought within the purview of the Tariff or are made chargeable to a specified rate of duty under the Tariff.

The rationale behind such a treatment is that since the goods were not excisable goods as per the provisions of section 2(d) at the time of manufacture, they would not be liable

to duty even though they are brought within the purview of the aforesaid section prior to removal from the factory.

- Exempted goods (excisable goods exempted from payment of duty vide an exemption notification) will be chargeable to duty at the time of removal if, subsequent to manufacture but before removal, the exemption from duty is withdrawn. In this case, since the goods were excisable at the time of manufacture, the rate of duty prevalent on the date of removal will be applicable.

The following table summarizes the above position:

| On the date of manufacture | On the date of removal | Leviability of excise duty |
|---|---|--|
| Goods not listed in the Tariff or rate column blank | Goods listed in Tariff and chargeable to duty @ 12% | Duty not leviable since goods were not excisable at the time of manufacture. |
| Goods liable to duty @ 10% in Tariff | Duty rate increased to 12% | Duty payable @ 12% since goods were excisable goods at the time of manufacture. |
| Nil rate in Tariff/Exempt | Duty imposed @ 10% | Duty chargeable @ 10% as goods were excisable goods at the time of manufacture (<i>NIL rate is also considered to be a rate of duty</i>) |

Illustration 2: Compute the excise duty payable in the following cases:

| S. No. | Value of goods (₹) | Date of manufacture | Rate of duty on date of manufacture | Date of removal | Rate of duty on date of removal |
|--------|--------------------|---------------------|---|-----------------|--|
| (i) | 10,000 | 28.02.2012 | 10% | 20.03.2012 | 12% |
| (ii) | 25,000 | 20.06.2013 | 12% | 25.09.2013 | 12% + Additional duty @ 6% imposed w.e.f. 01.07.2013 |
| (iii) | 30,000 | 23.06.2013 | Goods exempt from duty vide an exemption notification | 25.08.2013 | Exemption withdrawn – Goods liable to duty @ 12%. |
| (iv) | 60,000 | 25.02.2012 | 10% | 20.04.2012 | 15% |

Also, compute the duty payable in case the goods in point (i) above are to valued on the basis of tariff value and such tariff value changes from ₹ 10,000 (applicable on the date of manufacture) to ₹ 15,000 (applicable on the date of removal). The other particulars remain the same as in point (i) above.

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Further, in case of point (iv), goods have been removed from the factory and stored in a warehouse without payment of duty on 25.03.2012. On 25.03.2012, the applicable rate of duty was 12%. Who is liable to pay duty in this case?

In all the above cases, education cess @ 2% and secondary and higher education cess @ 1% has to be considered separately.

Solution: As per Rule 5 of the Central Excise Rules, 2002, the rate of duty or tariff value applicable to any excisable goods (other than khandsari molasses) is the rate or value in force on the date when such goods are removed from a factory or a warehouse, as the case may be. Therefore, the duty payable will be computed as follows:

| S. No. | Value of goods (₹) | Applicable rate of duty (inclusive of 3% education cesses) | Excise duty payable (₹) |
|--------|--------------------|---|-------------------------|
| (i) | 10,000 | 12.36% | 1,236 |
| (ii) | 25,000 | 12.36% [Since, excise duty is a levy on manufacture of excisable goods, the additional duty which was not in force on the date of manufacture cannot be imposed on goods removed after its levy.] | 3,090 |
| (iii) | 30,000 | 12.36% [Since, on the date of manufacture, the goods were excisable, the rate of duty on date of removal will be applied.] | 3,708 |
| (iv) | 60,000 | 15.45% [The applicable rate of duty is the rate prevalent on the date when goods are removed from the warehouse.] | 9,270 |

Since, the tariff value applicable to any excisable goods is the value in force on the date when such goods are removed from a factory, the applicable tariff value in this case will be ₹ 15,000 (value applicable on the date of removal). The excise duty payable will be ₹ 1854 (12.36% of ₹ 15,000).

In case of point (iv), where goods have been first stored in the warehouse without payment of duty and finally removed from the warehouse, the person liable to pay duty is the person who stores such goods in the warehouse and not the manufacturer.

Illustration 3: Madhavpur Sugar Ltd. produces khandsari molasses and supplies the same to TP Ltd. which, in turn uses it in the manufacture of a non-excisable commodity. Khandsari molasses worth ₹ 2,00,000 have been supplied by Madhavpur Sugar Ltd. to TP Ltd. Compute the duty payable from the following information:

| Particulars | Date | Applicable rate of duty (inclusive of 3% education cesses) |
|---|------------|--|
| Date of production | 26.02.2012 | 10.30% |
| Date of removal from the factory of Madhavpur | 28.02.2012 | 10.30% |

| | | |
|--|-------------------|---|
| <i>Sugar Ltd.</i> | | |
| <i>Date of receipt of molasses by TP Ltd.</i> | <i>18.03.2012</i> | <i>12.36%</i> |
| <i>Date of manufacture of non-excisable product in which molasses have been used</i> | <i>12.04.2013</i> | <i>Molasses have been exempted vide an exemption notification</i> |

Who is liable to pay duty in the above case?

Solution: *In case of molasses, the person who procures such molasses for use in the manufacture of any commodity, whether or not excisable, has to pay the duty leviable on such molasses, in the same manner as if such molasses have been produced by the procurer.*

The rate of duty applicable in the case of molasses is the rate in force on the date of receipt of such molasses in the factory of the procurer of such molasses.

Therefore, the relevant rate of duty will be 12% (rate applicable on the date of receipt of molasses in the factory of the procurer) and excise duty payable will be ₹ 24,720 (₹ 2,00,000 x 12.36%). Duty is payable by TP Ltd., the procurer of molasses, as if the molasses had been produced by it whether such molasses are used in manufacture of excisable or non-excisable commodity.

2.10 Classification of excisable goods

(1) What is classification?: There are thousands of varieties of manufactured goods. Since all goods do not carry the same rate or amount of duty, it is practically impossible to identify all the goods individually. Therefore, it is necessary to identify the goods through groups and sub-groups and then to determine the rate of duty on each group or sub-groups of goods. The exercise of placing the various excisable goods under the various groups or sub-groups is known as 'Classification' of a product.

In other words, the classification of excisable goods consists of determining the headings or sub-headings of the Central Excise Tariff Act, 1985 (CETA) under which the said goods would be covered.

(2) Why is classification necessary?: Classification of excisable goods is essential for determining the applicable rate of duty as different rates of duty are chargeable on different types of goods. It is also required for the purpose of determining eligibility to exemptions, most of which are with reference to the Tariff headings or sub headings.

(3) What is the scheme of classification?: CETA is based on the Harmonised System of Nomenclature (popularly known as HSN).

Harmonised System of Nomenclature: HSN is an internationally accepted product coding system formulated under the auspices of the General Agreement on Tariffs & Trade (GATT). The Central Excise Tariff Act is modelled along with international practices. The international practice of adopting a uniform classification internationally facilitates a common understanding of products across countries. In other words, the classification of a product under this code would be the same across the countries.

The two Schedules to CETA: The classification of goods in the CETA is comprised in two Schedules; the First Schedule specifies the rate of basic excise duty (CENVAT) and the Second Schedule specifies the rate of special excise duty.

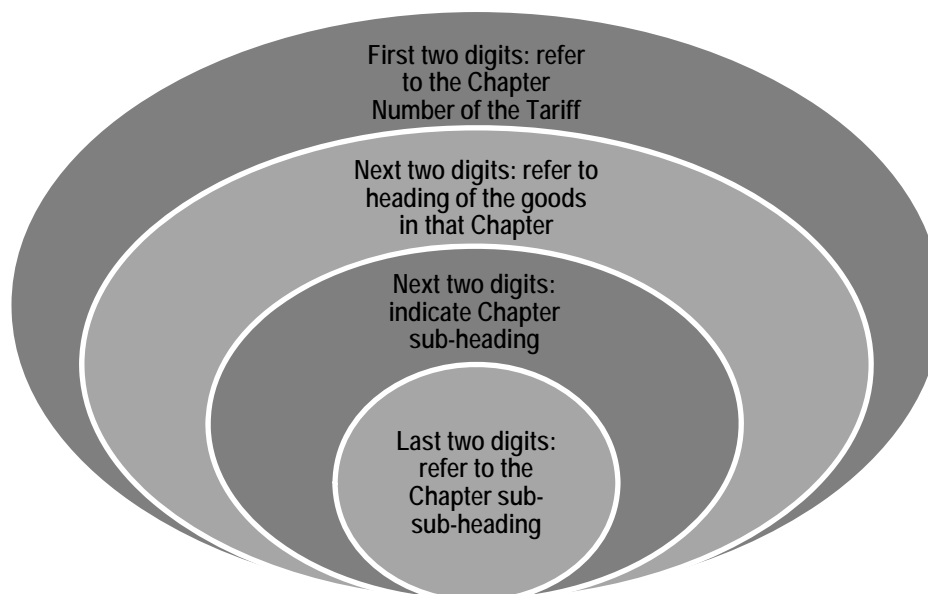
Sections and Chapters: The First Schedule has Sections and Chapters. Each Section has various Chapters. A Section represents a broad class of goods. For example, Section I relates to Live animals and Animal products while Section V relates to Mineral products.

A Chapter contains goods of one class e.g., Section – V of Mineral Products has Chapter 25 relating to Salt; sulphur; earths and stone; plastering materials; lime and cement and Chapter 26 relating to Ores, slag and ash. The Chapter is further divided into headings and sub-headings depending on different types of goods belonging to same class of products.

Section Notes and Chapter Notes are given at the beginning of each Section and Chapter which govern the entries in that Section and Chapter respectively.

The First Schedule to the CETA contains 96 Chapters grouped into 20 sections and specific code is assigned to each item. All of the items listed in the second schedule have been exempted from special excise duty with effect from 01.03.2006.

Eight digit classification system: The excisable goods are classified by using 8-digit system. Description with eight digits is termed as 'tariff item'. A tariff item under eight digit system would be interpreted as follows:-



[Fig. 12]

Example: Tariff Entry 3305 90 40 covers 'Hair dyes (natural, herbal or synthetic)'. The classification can be understood as-

33 refer to Chapter 33 'Cosmetic or toilet preparations, essential oil etc.'

05 refer to Heading 'Preparations for use on the hair'

90 refer to Sub-heading 'Other'

40 refer to the item 'Hair dyes (natural, herbal or synthetic)'

Interpretative Rules for classification: The Central Excise Tariff Act, 1985 incorporates six general rules of interpretation, which together provide necessary guidelines for classification of various products. By and large, these rules for interpretation are identical to those contained in the HSN.²

(4) What is trade parlance theory?: According to the trade parlance theory, if a product is not adequately classified in the Central Excise Tariff Act, 1985, it should be classified according to its popular meaning or meaning attached to it by those dealing with it, i.e., in commercial sense. However, where the tariff heading itself uses highly scientific or technical terms, goods should be classified in scientific or technical sense.

(5) Rate of duty: CETA specifies the rate of duty in respect of each tariff entry given in the Chapters there under. The rate of duty may either be a specific rate, i.e., quantified in terms of money or may be *ad valorem*, i.e., a percentage of the value of the goods. If the rate of duty is specific (a certain quantum of money), the assessee is required to pay that amount.

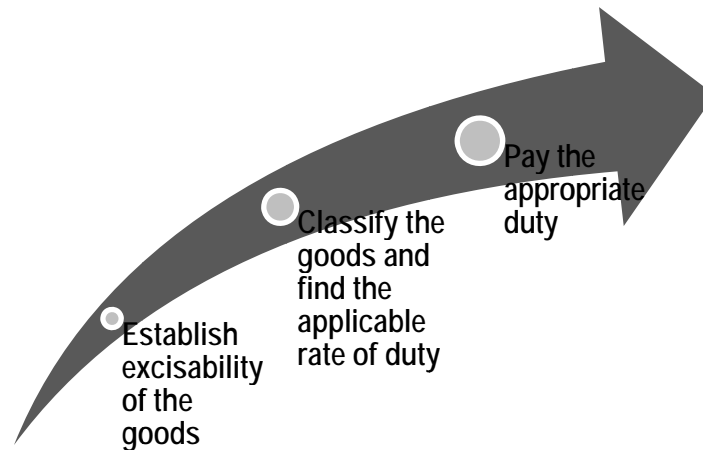
However, if the rate of duty is *ad valorem*, the assessee has to determine the assessable value of the particular product and thereafter, apply the rate of duty to such derived assessable value. The process of determining the assessable value of a product is known as 'valuation'.

Significance of exemption notifications: The effective rate of duty must be ascertained by considering the various exemption notifications issued from time to time. The rate of duty read with the rate prescribed in the notification, if any, will ultimately determine the effective rate of duty payable on clearance of goods.

2.11 Valuation of excisable goods

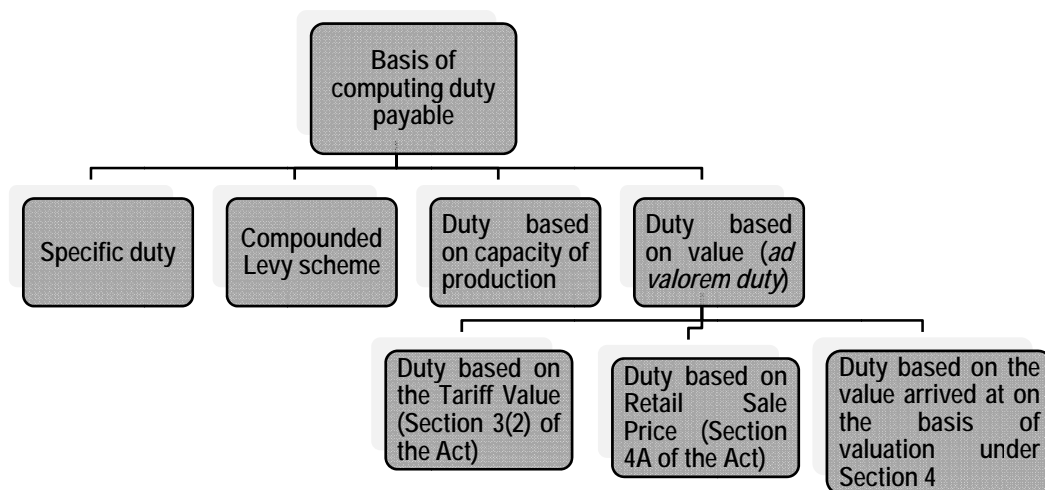
After establishing the excisability of the goods, classifying them correctly and finding the applicable rate of duty, the next step is to pay the duty.

² The Interpretative Rules will be discussed at the Final Level.



[Fig. 13]

However, it is important to know that duty is payable on more than one basis:



[Fig. 14]

(a) **Specific duty:** In the case of some goods, duty is payable on the basis of certain unit, length, weight, volume, etc. Duty is calculated quite easily by following this method. However, specific duties do not keep pace with inflation i.e., even if selling price of product rises, revenue earned by Government does not increase correspondingly. Hence, more and more tariff entries are designed based on *ad valorem* duty structure.

Example: Duty payable on cigarettes is on the basis of length.

(b) **Compounded levy scheme:** In sectors where there are large numbers of small manufacturers, it is not practically feasible for the Department to exercise normal excise controls and procedures. At the same time, small manufacturers find it difficult to comply with the complicated excise procedures.

Under this scheme, the assessee has the **option** to pay the duty of excise on the basis of specified factors relevant to production of the goods covered under the scheme (size of equipment employed, number and the types of machines used for manufacture etc.) at the specified rates. The prescribed duty has to be paid by the assessee for the specified period. The advantage of this scheme is that it frees the manufacturer from observing day to day central excise formalities and maintenance of detailed accounts after making the lump sum periodic payment.

Example: Stainless steel pattas/pattis and aluminium circles are covered under this scheme. The rate of duty is ₹ 40,000 and ₹ 12,000 pm per cold rolling machine for stainless steel pattas/pattis and aluminium circles respectively (Education cess and secondary and higher education cess to be added separately).

(c) Duty based on capacity of production: This duty is payable on the basis of production capacity, without any reference to the actual production. The production capacity is determined as per the rules made in this regard. The Government may notify the goods which will be assessed to such duty having regard to the nature of the process of manufacture or production of excisable goods of any specified description, the extent of evasion of duty in regard to such goods or such other factors as may be relevant. This duty is mandatory i.e., duty cannot be paid in any other manner in respect of the goods notified under this scheme.

Example: Pan masala, gutkha, tobacco etc. are notified under this scheme.

(d) Duty based on value: In (a), (b) and (c) above, valuation of excisable goods is not required as duty is not based on the value of the goods. However, if the rate of duty is *ad valorem*, i.e., duty is expressed as a percentage of the value of goods; valuation of the excisable goods becomes essential. Significance of valuation increases as majority of the excisable goods are charged to *ad valorem* duty. Thus, in case of goods chargeable to *ad valorem* duty, for calculating the amount of duty payable, first the assessable value of the goods has to be determined.

Illustration 4: Determine the excise duty payable in the following cases:-

| Goods | Qty. (kg) | Value of goods (₹) | Rate of duty |
|-------|-----------|--------------------|--------------|
| A | 1,000 | 20,00,000 | ₹ 20 per kg |
| B | 100 | 10,00,000 | 12% |

Education cesses @ 3% are leviable separately.

Solution:

Computation of excise duty payable

Goods A: Since rate of duty is per kg, value of such goods is not relevant. Excise duty payable will be computed on the basis of the quantity of the goods produced. Therefore, excise duty payable will be:

| | | |
|----------------------------------|---|-----------------|
| 1,000 kg x ₹ 20 per kg | = | ₹ 20,000 |
| Add: 3% education cesses | = | ₹ 600 |
| Total excise duty payable | = | ₹ 20,600 |

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Goods B: Since, in this case the rate of duty is a percentage of the value of excisable goods, the quantity of the goods produced is not relevant. Excise duty payable will be computed on the basis of the value of the goods. Therefore, excise duty payable will be:

$$\begin{aligned}\text{₹ } 10,00,000 \times 12\% &= \text{₹ } 1,20,000 \\ \text{Add: 3\% education cesses} &= \text{₹ } \underline{3,600} \\ \text{Total excise duty payable} &= \text{₹ } 1,23,600\end{aligned}$$

Ad valorem duty is payable on the basis of the values prescribed under the Act namely, tariff value fixed by the Government in respect of certain goods; transaction value and value based on retail sale price printed on a package of goods.

(i) **Tariff value:** The Central Government is empowered to notify the values of goods which will be chargeable to *ad valorem* duty. In such a case, the task is easy since the value is already fixed. The Central Government has also got the power to alter the tariff value once fixed. However, in recent years tariff values have rarely been fixed by the Government. The duty in such cases is the percentage of such tariff value and not the assessable value.

Example: The Central Government has fixed tariff value for jewellery (other than silver jewellery) under heading 7113 and branded readymade garments under Chapter 61 and 62 as 30% of the transaction value declared in the invoice and 30% of the retail sale price of the ready garments respectively.

The Central Government may fix different tariff values for different classes or descriptions of the same excisable goods. The Central Government can also fix different tariff values for same class or description of the goods but produced or manufactured by different classes of producers or manufacturers or sold to different classes of buyers. Such tariff values may be fixed on the basis of wholesale price or average price of various manufacturers as the Government may consider appropriate.

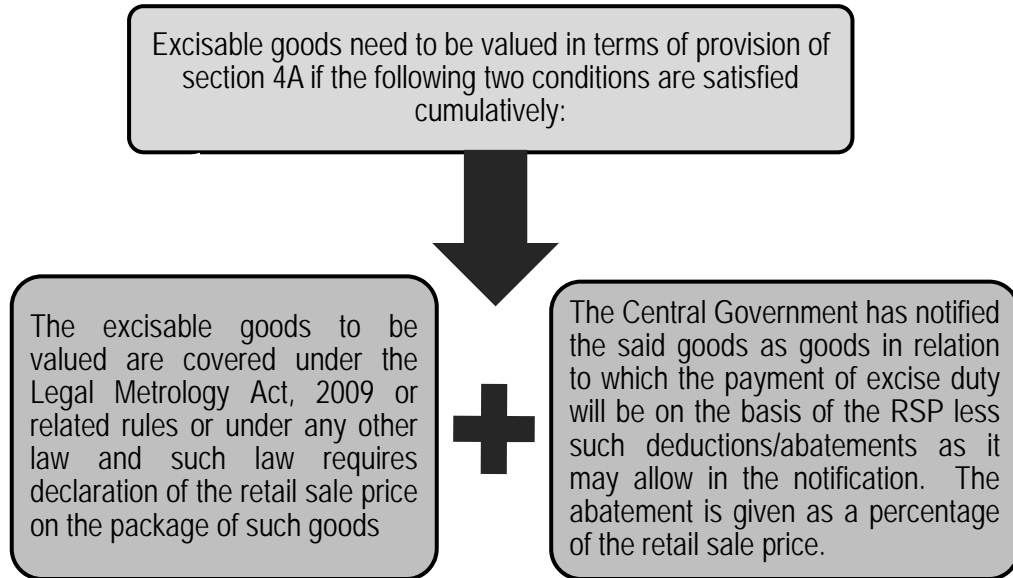
Illustration 5: X Ltd. manufactured readymade garments for ₹ 10 lakh (exclusive of all taxes). The retail sale price of such garments is ₹ 30 lakh. The rate of duty is 12.36% (inclusive of 3% education cesses). The tariff value is notified at 30% of retail sale price. Compute the excise duty payable.

Solution: Since the goods are such for which tariff value has been fixed by the Central Government, the excise duty will be payable on the basis of tariff value.

Tariff Value = ₹ 9,00,000 [30% of ₹ 30 lakh (RSP)]

Excise duty payable = 12.36% of ₹ 9,00,000 = ₹ 1,11,240.

(ii) **Valuation with reference to retail sale price (RSP):** Section 4A of the Act provides for valuation of excisable goods based on the retail sale price.



[Fig. 15]

Examples:

| Goods notified under section 4A | Rate of Abatement (%) |
|---------------------------------|-----------------------|
| Biscuits | 30% |
| Toothbrush | 30% |
| Photographic cameras | 30% |
| Pressure cooker | 25% |

Meaning of Retail Sale Price

Retail sale price has been defined to mean the maximum price at which the excisable goods in packaged form may be sold to the ultimate consumer and includes all taxes, local or otherwise, freight, transport charges, commission payable to dealers, and all charges towards advertisement, delivery, packing, forwarding and the like, as the case may be, and the price is the sole consideration for such sale.

However, if the provisions of the Act, rules or Legal Metrology Act, 2009 require the retail sale price to exclude any taxes, local or otherwise, the retail sale price shall be construed accordingly.

The following points merit consideration in this regard:

- **All goods bearing RSP not covered under section 4A:** It is important to note that all goods on which RSP has been declared will not be covered under the provisions of section 4A. Only when the declaration of RSP on the goods is mandatory under the Legal Metrology Act, 2009 or under any other law and such goods have been notified by

the Central Government for the purpose of section 4A, will the goods be valued under section 4A. The provisions do not apply in cases where manufacturers voluntarily affix RSP on the products.

- **Value = RSP printed on the package – Abatement, if any, notified by the Government**

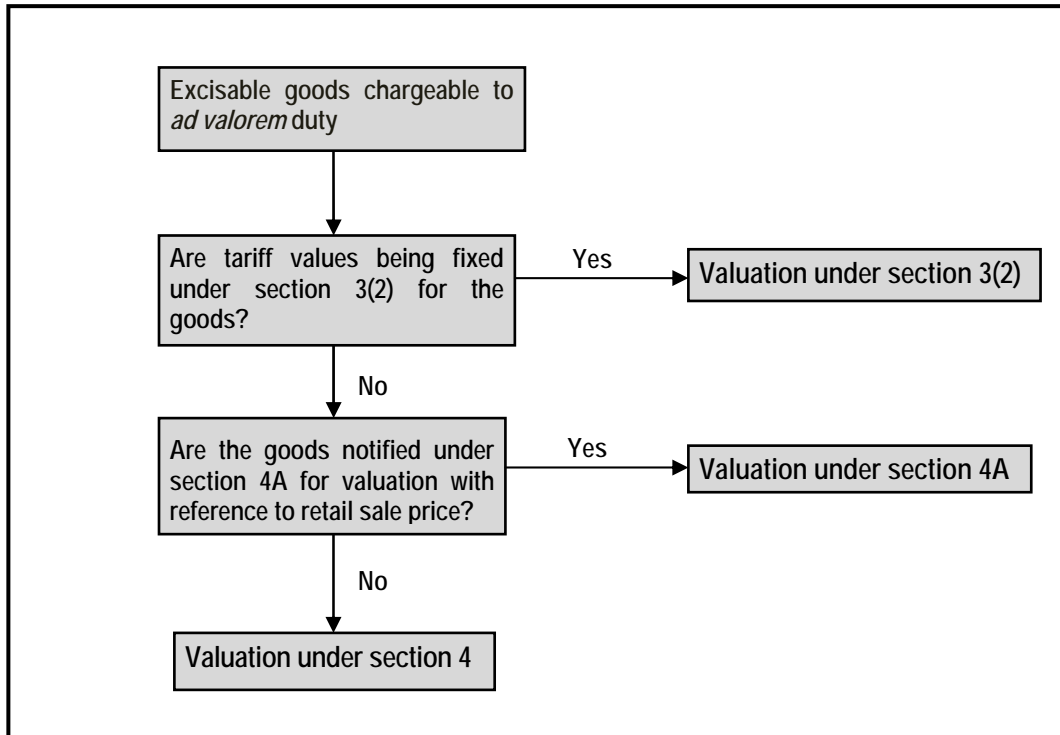
***Illustration 6:** RSP printed on the package of a pressure cooker is ₹ 5,000 (inclusive of all taxes). Declaration of RSP on package of pressure cooker is required under the provisions of Legal Metrology Act, 2009 and has also been notified by the Central Government for the purpose of section 4A. The prescribed rate of abatement is 25%. The applicable rate of duty is 12% plus 2% education cess and 1% secondary and higher education cess. Compute the duty payable.*

***Solution:** The value under section 4A will be (₹ 5000 – 25% of ₹ 5000) = ₹ 3750. Excise duty payable will be ₹ 464 (12.36% of ₹ 3,750) rounded off.*

- **Maximum RSP deemed to be the RSP, if more than one RSP declared:** Where more than one RSP is declared on the package of excisable goods, the maximum of such price will be deemed to be the RSP.
- **Each RSP deemed to be the RSP, if different RSPs on different packages meant for different areas:** Where RSPs are declared on different packages for the sale of any excisable goods in packaged form in different areas, each such RSP will be RSP for the purposes of valuation of the excisable goods intended to be sold in the area to which the retail sale price relates.
- **Increased RSP deemed to be the RSP, if RSP increased after removal from factory:** If the RSP declared on the package of excisable goods at the time of its clearance from the place of manufacture, is increased, such increased RSP will be deemed to be the retail sale price.
- **RSP declaration not mandatory on wholesale packages:** RSP declaration is compulsory in case of retail packages meant for sale to ultimate consumer. However, RSP declaration is not mandatory on wholesale packages, packaged commodities for institutional/ industrial consumers, agricultural farm produce etc.

(iii) Transaction value:

(1) Concept: In case where any of the above-mentioned methods of excise valuation are not applicable, assessable value of the goods is to be computed in terms of 'transaction value' of the goods as provided under section 4 of the Act. In other words, where a product is not covered under specific duty scheme, compounded levy scheme, production capacity based duty, tariff value provisions, RSP based valuation, the last method i.e., residual method based on transaction value is applicable. The scheme of *ad valorem* valuation in general is summarized below:



[Fig. 16]

The concept of 'transaction value' has been introduced under section 4 from July 1, 2000. Prior to 1st July 2000, the valuation under this section was based on the principle of 'normal price' which was based on the wholesale prices at which manufacturer ordinarily sold the goods.

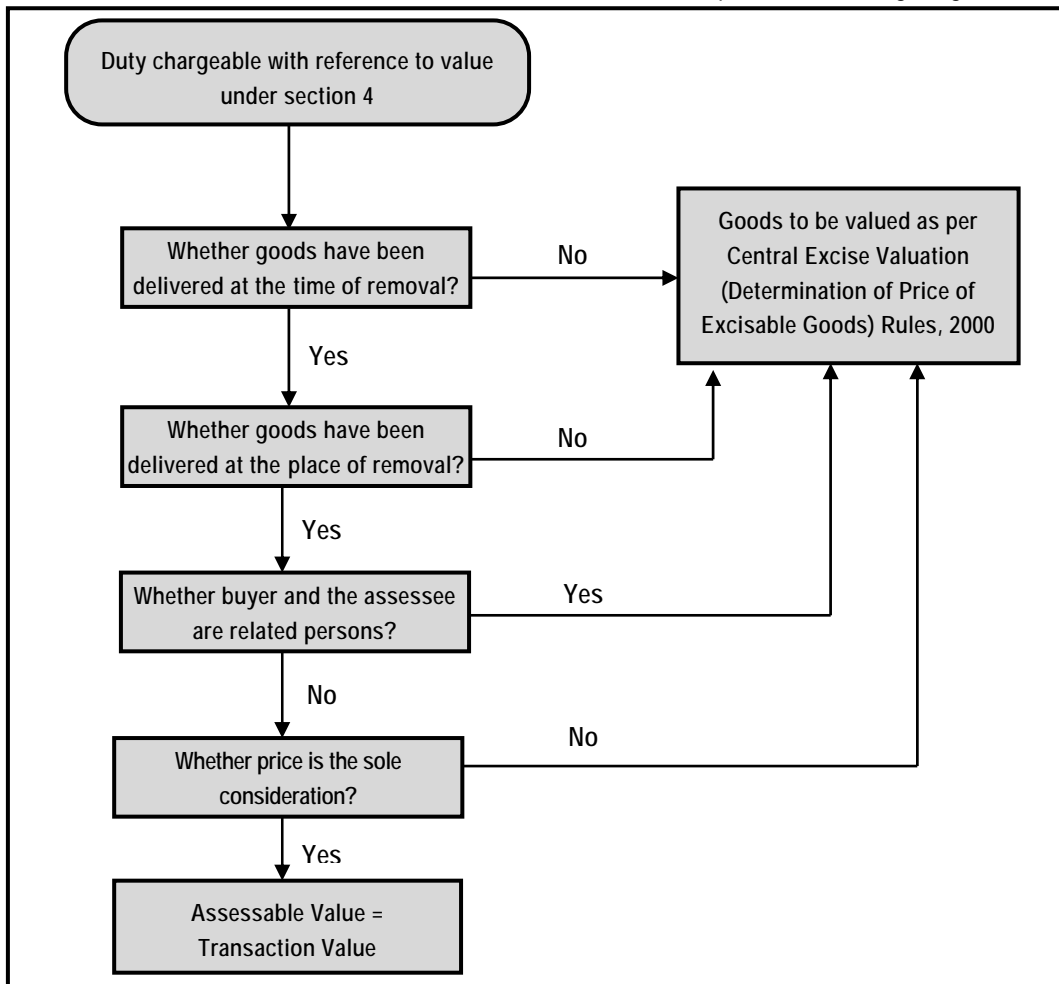
Assessable value to be the transaction value: As per section 4, assessable value of the excisable goods shall be the 'transaction value' if the following conditions are satisfied:-

- (a) The price is the sole consideration for the sale. In other words, the assessee must not receive any other sum either by way of money or by way of any other assistance for the manufacture of goods.
- (b) The assessee and the buyer of the goods are not related persons.
- (c) Goods have been sold by the assessee for delivery at the time and place of removal.

In all other cases, which do not fulfill the aforesaid conditions, value is to be determined as per the provisions of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000³.

³ The Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 will be discussed at the Final Level.

Valuation under section 4 can be better understood with the help of the following diagram:



[Fig. 17]

(2) Relevant definitions:

(a) **Transaction value** means the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter; but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.

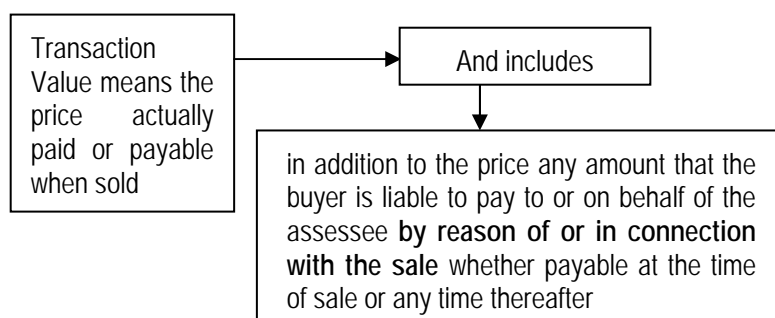
(b) **Assessee** means the person who is liable to pay the duty of excise under this Act and includes his agent.

(c) Persons shall be deemed to be "related", if

- (i) they are inter-connected undertakings;
(In a general sense, inter-connected undertakings have 25% common control through ownership, or management.)
- (ii) they are relatives;
(Only natural relationships can be covered under this like husband, wife, members of HUF etc.)
- (iii) amongst them the buyer is a relative and a distributor of the assessee, or a sub-distributor of such distributor; or
- (iv) they are so associated that they have interest, directly or indirectly, in the business of each other.
- (d) **Place of removal** means –
 - (i) a factory or any other place or premises of production or manufacture of the excisable goods.
 - (ii) a warehouse or any other place or premises wherein the excisable goods have been permitted to be deposited without payment of duty.
 - (iii) a depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearance from the factory
 from where such goods are removed.
- (e) **Time of removal** in respect of the excisable goods removed from the place of removal referred to above shall be deemed to be the time at which such goods are cleared from the factory.

(3) **ANALYSIS of the definition of transaction value:** The definition of transaction value is an all inclusive definition. It is important to bear in mind that the concept of transaction value is quite different from the concept of price and such value can include many items which may classically have not been understood to be part of the sale price.

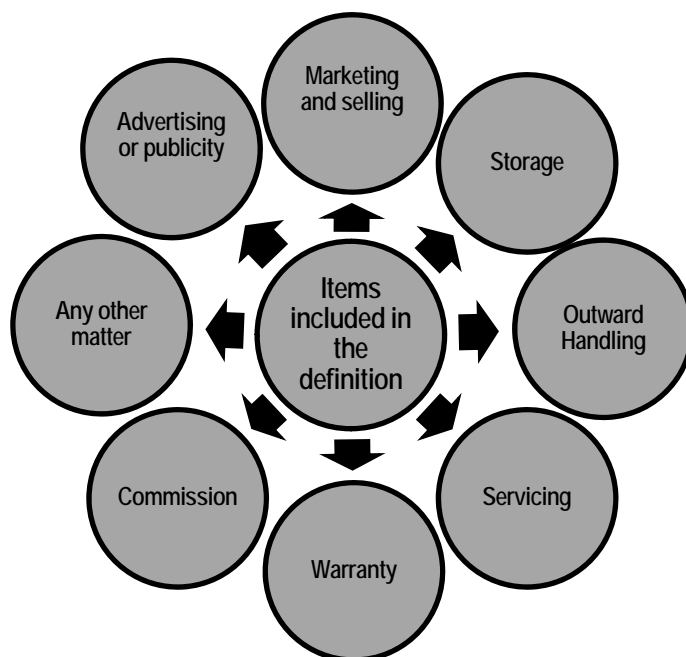
Let us analyze the definition of transaction value through the use of flow charts.



[Fig. 18]

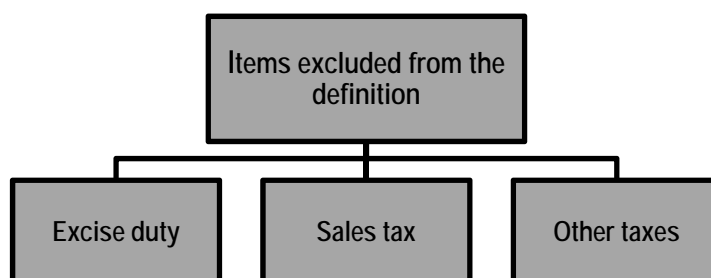
The definition also gives an illustration of the kind of amounts that are included as additions to price which the buyer may be liable to pay to or on behalf of the assessee. It is important to

note that the definition specifically states as "including but not limited to" which clearly means that the items included in the definition are only illustrative and more may be includible



[Fig. 19]

It is clear that the above are includible only if the buyer is liable to pay the same or if he pays the same on behalf of the assessee.



[Fig. 20]

The above are not includible, if actually paid or payable.

Includibility or otherwise of a few significant items of cost in the transaction value (apart from the ones already provided in the definition) is given hereunder:

(4) Inclusions/Exclusions in/from transaction value:

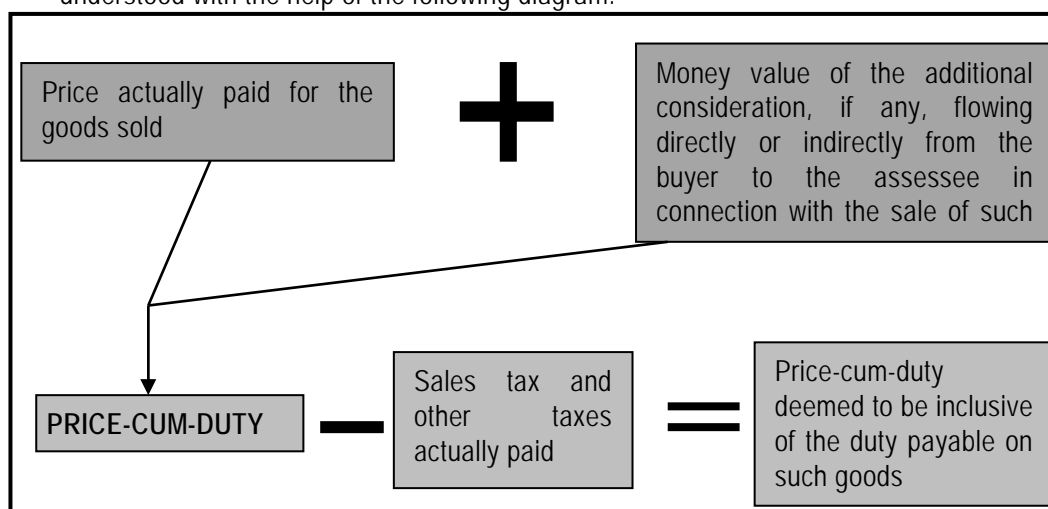
| | Items of cost | Includibility in transaction value or otherwise |
|----|------------------|--|
| 1. | Outward handling | Includible only upto place of removal and if incurred by |

| | | |
|-----|---|--|
| | | buyer as a condition of sale of goods. |
| 2. | Packing | Cost of all forms of packing (special, general, protective, etc.) are includible. However, cost of durable/reusable packing is not included as it is amortized and included in the cost of product itself. Therefore, separate addition is not necessary unless audit of accounts reveal that such cost has not been amortized and included in the value of the product. |
| 3. | Dharmada charged in the invoices and recovered from customers | Includible. |
| 4. | Design, development and engineering charges | Includible if they are specific to goods produced as goods cannot be produced without them. |
| 5. | Bought out items and accessories | Essential Items- Includible as product cannot function without the same. However, the item should be fitted to the main article at the time of removal. Optional bought out items and accessories- Not includible. (Accessory means an object or device not essential in itself but adding to beauty, convenience or effectiveness of something else.). |
| 6. | Consultancy charges | Includible if it relates to design, layout, etc. of final product; and such activity is done upto place of removal. |
| 7. | Testing & inspection charges | Includible but independent testing done by the buyer himself or through a third party is not includible. |
| 8. | Erection, installation and commissioning charges | Not includible if it results in immoveable property. |
| 9. | Pre-delivery inspection charges and after sales services | Includible only if it is collected by the manufacturer. |
| 10. | Discounts (Trade and Cash) | All forms of discount (trade discount, cash discount, quantity discount, turnover discount, differential discounts to different buyers, damage discount) are excludible as the same are already factored into the definition of transaction value. However, the discount should be actually passed on to the buyers. |
| 11. | Notional interest on deposits, advances | Not includible unless it can be proved that price has been lowered on account of receipt of such advance from the buyer. |
| 12. | Interest on delayed | Not includible as interest is nothing but finance charges |

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| | | |
|-----|--|---|
| | payment of receivables | and cannot be considered as payment by reason of sale. |
| 13. | Bank charges for collection of sale proceeds | Not includible as the same cannot be considered as payment by reason of sale. |
| 14. | Delayed payment charges | Not includible as "transaction value" relates to the price paid or payable for the goods and delayed payment charge is nothing but the interest on the price of the goods which is not paid during the normal credit period. However, to be admissible as deduction it should be separately shown or indicated in the invoice and should be charged over and above the sale price of the goods. |
| 15. | Freight | Not includible. However, if, sale is from depot, freight from factory to depot will be includible. |
| 16. | Transit insurance | Not includible as it is a part of transportation cost. However, it should be shown separately in the invoice. |

- (5) **Price-cum-duty:** Price-cum duty of the excisable goods sold by the assessee can be understood with the help of the following diagram:



[Fig. 21]

The following points merit consideration in this regard:

- **Situations when the price charged will be taken as price-cum-duty:**
 - If the assessee has collected less duty from buyer than what is due; or
 - If the assessee has not collected any duty from the buyer even though the product is liable to duty; or

- If the assessee has paid duty on lesser value due to receipt of additional consideration.

In the above situations, the price charged (exclusive of sale-tax/local taxes) shall be regarded as price-cum-duty.

- The assessable value and the duty payable in such a case will be:

$$\text{Assessable Value} = \frac{\text{Price-cum-duty} \times 100}{(100 + \text{Rate of excise duty})}$$

$$\text{Duty payable} = \frac{\text{Price-cum-duty} \times \text{Rate of duty}}{(100 + \text{Rate of excise duty})}$$

- **Duty to be separately indicated in invoice:** Every person liable to pay duty of excise should prominently indicate in all the documents/invoice, etc., the amount of such duty which will form part of the price at which such goods are to be sold. It is also the responsibility of such person to deposit any sum collected from the buyer in name of excise duty with the Government.

Illustration 7: What will be the assessable value of the excisable goods in the following cases?

- (i) The price-cum-duty of excisable goods sold by 'A' is ₹ 200 per unit. Excise duty @ 8% has been charged by 'A' on such goods. However, 'A' comes to know that the actual rate of duty chargeable on the goods sold by him is 12% and not 8%. 'A' has collected only ₹ 200 per unit from the customers.
- (ii) 'B' sells his excisable goods @ ₹ 200 per unit (inclusive of excise duty @ 12%). However, it has been found that 'B' has collected ₹ 50 per piece separately.
- (iii) The price of the excisable goods sold by 'C' is ₹ 500 per unit. 'C' does not charge any duty of excise in his invoice on the belief that the goods sold by him are exempt from payment of duty vide an exemption notification. However, he comes to know that the goods are not exempt from excise duty but are liable to duty @ 12%.

In all the above cases education cesses have to be considered separately.

Solution:

| Particulars | Price-cum-duty charged (per unit) [₹] | Additional consideration [₹] | Actual price-cum-duty (including additional consideration) [₹] | Correct rate (including 3% education cesses) [%] | Value (₹) | Duty payable (₹) |
|-------------------|---------------------------------------|------------------------------|--|--|-------------------------------|------------------|
| | (A) | (B) | (C) | (D) | (E) = (C) × 100 ÷ [100 + (D)] | (F) = (E) × (D) |
| Goods sold by 'A' | 200 | - | 200 | 12.36 | 178 | 22 |

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| | | | | | | |
|-------------------|-----|----|-----|-------|-----|----|
| Goods sold 'B' | 200 | 50 | 250 | 12.36 | 222 | 28 |
| Goods sold by 'C' | 500 | - | 500 | 12.36 | 445 | 55 |

Note: All the amounts have been rounded off to nearest rupee.

Illustration 8: Calculate the assessable value and the excise duty payable from the following particulars:

| | |
|--|---------|
| List price of the product (inclusive of taxes) | ₹ 5,960 |
| Trade discount | 10% |
| VAT | 12.5% |
| Excise duty | 12% |
| Education cesses as applicable | |

An exemption notification grants exemption of 50% of the duty payable on this product.

Solution:

| Particulars | (₹) |
|---|-------------------|
| List price of the product | 5,960 |
| Less: Trade discount | <u>596</u> |
| Price net of discounts but including taxes | 5,364 |
| Less: VAT [(₹ 5,364 x 12.5)/112.5] | <u>596</u> |
| Price-cum-duty (a) | 4,768 |
| Less: Excise duty @ 6% (on account of 50% exemption) [(₹ 4,768 x 6)/106] (rounded off to nearest rupee) | 270 |
| Education cess @ 2%(rounded off) | 5 |
| Secondary and Higher education cess @ 1%(rounded off) | <u>3</u> |
| Total excise duty including education cesses (b) | <u>278</u> |
| Assessable value (a) – (b) | 4490 |

Illustration 9: Determine the transaction value and the duty payable from the following particulars:

| | ₹ |
|---|----------|
| (i) Price of machinery excluding taxes and duties | 5,50,000 |
| (ii) Installation and erection expenses [Machinery has been fixed to the earth] | 21,000 |
| (iii) Packing charges (primary and secondary) | 11,500 |
| (iv) Design and engineering charges | 2,000 |
| (v) Dharmada | 500 |

Other information:

- (a) Cash discount @ 2% on price of machinery was allowed as per terms of contract since full payment was received before dispatch of machinery.
- (b) Bought out accessories valued at ₹ 6,000. The accessories are optional and provide ease of use of the machinery.
- (c) Central excise duty @ 12% and educational cess as applicable @ 3%.

Make suitable assumptions as are required and provide brief reasons.

Solution:

Determination of excise duty payable

| <i>Particulars</i> | <i>₹</i> |
|--|----------------------|
| <i>Price of machinery</i> | <i>5,50,000</i> |
| <i>Add: Packing charges (Note 1)</i> | <i>11,500</i> |
| <i>Design and engineering charges (Note 1)</i> | <i>2,000</i> |
| <i>Dharmada (Note 1)</i> | <i>500</i> |
| <i>Total</i> | <i>5,64,000</i> |
| <i>Less : 2% cash discount on price of machinery [₹ 5,50,000 x 2 %] (Note 4)</i> | <i>11,000</i> |
| <i>Assessable value</i> | <i>5,53,000</i> |
| <i>Excise duty @ 12.36%</i> | <i>68,350.80</i> |
| <i>Excise duty payable [rounded off]</i> | <i>68,351</i> |

Notes:-

While computing the assessable value:-

1. *packing charges, design and engineering charges and dharmada have been included as such payments are 'in connection with sale'.*
2. *installation and erection expenses have not been included as they result in immovable property which is not goods.*
3. *value of bought out accessories has not been included as they are optional and do not provide any value addition.*
4. *cash discount has been allowed as deduction as it has been passed on to the buyer.*

2.12 Small scale industry (SSI) exemption

Considering the significant contribution of small scale sector towards the industrial growth of the Indian economy and to the Gross Domestic Product, excise duty concessions have been granted under the central excise law to small scale units so as to make them competitive in the domestic and global market. The excise duty concessions have been extended to the SSI units by way of exemption notifications. Currently, *Notification No. 8/2003 CE dated 01.03.2003* grants SSI exemption.

(1) **Meaning of SSI unit:** Small Scale Units are not defined in the Act or the rules made thereunder. It is important to note here that the definition of a SSI unit adopted commonly for trade purposes is not applicable under central excise. Under central excise, the basis for ascertaining whether a unit is a SSI, is the value of clearances of the unit in the previous financial year.

(2) **Eligible goods:** SSI exemption is restricted to the products listed in the SSI exemption notification. Though the notification covers most of the products, few products like tobacco products, pan masala, watches, matches and some textile products are specifically excluded from SSI exemption.

(3) **Eligible SSI units:** The units whose value of clearances of excisable goods for home consumption computed in accordance with the notification (mentioned above) does not exceed ₹ 400 lakh (4 crore) in the previous financial year are eligible for SSI exemption. The turnover limit is calculated by taking into account the clearances in respect of one manufacturer from one or more factories or from a factory by one or more manufacturers.

Example: If ABC Ltd. wants to claim SSI exemption in the year 2014-2015, then the value of its clearances for the year 2013-2014 should not exceed ₹ 4 crore. Further, if ABC Ltd. has started its business only in the year 2014-2015, then it is entitled for SSI exemption in the year 2014-2015 as its previous year clearances are nil.

(4) **SSI exemption:** The excisable goods covered by the notification are exempt from the whole of the duty up to the aggregate value of clearance of ₹ 1.5 crore in any financial year if the turnover of the unit does not exceed ₹ 4 crores in previous year⁴. In simple words, a unit whose turnover does not exceed ₹ 4 crores in the previous year is entitled to full exemption from payment of duty on its first clearances of up to ₹ 150 lakh in the current financial year.



[Fig. 22]

(5) **Availability of CENVAT credit:** A SSI unit can avail CENVAT credit on inputs only after it starts paying duty. However, CENVAT credit of capital goods can be availed (but can be utilized only after the turnover crosses ₹ 150 lakh) even if the same have been received during period of exemption.

(6) **Goods bearing brand name of others:** SSI exemption is not available in respect of

⁴ The manner of calculating the limits of ₹ 400 lakh and ₹ 150 lakh and other provisions of SSI exemption will be discussed in detail at the Final Level.

clearances bearing a brand name of another person. This means that such clearances attract normal rate of duty. Brand name or trade name is any mark, symbol, monogram, label, signature or inventor word or writing which may or may not be registered. Brand or trade name must indicate a connection in the trade between the goods and the person using such mark or name.

Exception: There are certain types of goods which are entitled to SSI exemption even though they bear the brand name of other person e.g. goods manufactured in rural area, packing material, account books, registers, writing pads.

Illustration 10: (i) ABC Ltd. wants to claim SSI exemption in the year 2014-2015. Its clearances for the year 2013-2014 are ₹ 3 crore. ABC Ltd. manufactures goods bearing brand name of XYZ Ltd. Is ABC Ltd. eligible for SSI exemption?

(ii) ABC Ltd. wants to claim SSI exemption in the year 2014-2015. Its clearances for the year 2013-2014 are ₹ 3 crore. ABC Ltd. manufactures goods bearing brand name of XYZ Ltd. in rural area. Is ABC Ltd. eligible for SSI exemption?

Solution:

- (i) ABC Ltd. is not eligible for SSI exemption as it manufactures goods bearing brand name of others.
- (ii) ABC Ltd. is eligible for SSI exemption even though the goods manufactured by it bears the brand name of others as it manufactures goods in rural area.

2.13 General procedures⁵

(1) Registration: Every manufacturer of excisable goods other than the ones specifically exempted is required to get his premises registered under the central excise law. Registration is also required for every prescribed person who carries on trade or holds private store-room or warehouse or otherwise uses excisable goods.

A manufacturer is exempt from the requirement of getting his premises registered so long as the goods manufactured by him attract Nil rate of duty or remain exempt from the whole of the duty of excise leviable thereon. Small scale units availing the benefit of SSI exemption notification are also exempt from obtaining registration. However, such units are required to give a declaration in a specified form once the value of their clearances touches ₹ 90 lakhs.

After the assessee applies for the registration in the prescribed manner, he is issued a 15 digit PAN based alphanumeric registration number and a registration certificate on completion of the registration procedure. The registration certificate is valid till the relevant unit is engaged in manufacture of excisable goods. It is not required to be renewed.

(2) Payment of excise duty: The due dates and other provisions relating to payment of duty have been tabulated below:

⁵ The procedures under central excise will be discussed in detail at the Final level. In this unit, a bird's eye view of the significant procedures under central excise has been given to familiarize the students with the basic aspects of such procedures.

1.48 Indirect Taxes

| Type of Assessee | Periodicity | Due date for payment of duty | |
|--|---------------------------|--|--|
| | | In case of e-payment | Other than e-payment |
| Assessee eligible for SSI exemption (An eligible unit is one whose aggregate value of clearances does not exceed ₹ 400 lakh in the preceding financial year) | Quarterly payment of duty | 6th day of the month following the relevant quarter. | 5th day of the month following the relevant quarter. |
| | | For goods removed during the quarter ending in March, 31st day of March. | |
| Other assesseees | Monthly payment of duty | 6th day of the month following the relevant month. | 5th day of the month following the relevant month. |
| | | For goods removed during the month of March, 31st day of March. | |

The following points merit consideration in this regard:

- **E-payment of duty:** *All assesseees are mandatorily required to pay the excise duty electronically through internet banking. However, the Assistant/Deputy Commissioner of Central Excise may for reasons to be recorded in writing, allow the assessee to deposit excise duty by any mode other than internet banking.*
- **EASIEST:** For e-payment, assesseees should open a net banking account with one of the authorized banks. For effecting payment, assesseees can access the ACES website and click on the e-payment link that will take them to the EASIEST portal or they can directly visit the EASIEST portal.
- **Interest @ 18% on delayed payment of duty:** Failure to pay the amount of duty by due date attracts interest at the rate @ 18% per annum on the outstanding amount.
- **Duty may be paid in cash or by utilizing CENVAT credit:** Duty may be paid in cash through account current, popularly known as PLA (Personal Ledger Account). Duty can also be paid by utilizing the CENVAT credit balance available at the end of the month, even though duty is payable by 5th/6th of following month.

(3) Invoice: An invoice is the document under cover of which the excisable goods are to be cleared by the manufacturer. Therefore, excisable goods cannot be removed from a factory or a warehouse except under an invoice signed by the owner of the factory or his authorized agent.

Serially numbered: The invoice should be serially numbered. The serial number shall commence from 1st April every year (beginning of a financial year). Such serial numbers need to be intimated to the Superintendent of Central Excise having jurisdiction over the factory of the assessee, before issuing the invoices.

Contents: The invoice should contain the registration number, address of the jurisdictional Central Excise Division, name of consignee, description, classification, time and date of removal, rate of duty, quantity, mode of transport, vehicle registration number and value of goods and the duty payable thereon.

Number of copies: The invoice has to be prepared in triplicate in the following manner, namely:-

- i. the original copy being marked as ORIGINAL FOR BUYER;
- ii. the duplicate copy being marked as DUPLICATE FOR TRANSPORTER;
- iii. the triplicate copy being marked as TRIPLICATE FOR ASSESSEE.

(4) Returns under central excise: A central excise assessee is required to file certain periodic returns, which relate to his tax liability and other transactions. Some significant returns to be filed by different categories of central excise assessee and their respective due dates are given in the following table:

| Form of Return | Category of assessee | Periodicity | Due date |
|--|---|-------------|---|
| ER-1 | All assessee except SSI | Monthly | By 10th day of the month following the relevant month |
| ER-3 | Assessee eligible for SSI concession (even if he does not avail the concession) | Quarterly | By 10th day of the month following the relevant quarter |
| ER-4 [Annual Financial Information Statement] | Assessee paying duty of ₹ 1 crore or more per annum either through PLA or CENVAT or both together | Annually | By 30th November of the succeeding year |

Note: All the above returns have to be filed electronically.

Note: The rates of duties, wherever mentioned in the illustrations may not always be the actual rate prevalent during the period in question. They may be hypothetical rates assumed to explain the provisions of law with more clarity.

UNIT – 3: CUSTOMS DUTY

Learning objectives

After reading Unit- 3 of this Chapter, you will be able to understand:

- ◆ the concept of customs duty
- ◆ the Constitutional provisions relating to levy of customs duty
- ◆ the different types of customs duties and their computation
- ◆ the sources of customs law
- ◆ the various provisions relating to levy of customs duty namely, application of the Customs Act, charge of customs duty and taxable event
- ◆ exceptions to the levy of customs duty
- ◆ exemption from the customs duty
- ◆ the concepts of classification and valuation of imported/export goods in brief
- ◆ as to how to determine the relevant date for determination of rate of exchange
- ◆ as to how to determine the rate of duty and tariff valuation of imported and export goods

Apart from the above, after you finish reading this Unit, you will also get a brief idea of the import and export procedures under the customs law.

3.1 What is customs duty?

Customs duty is a duty or tax, which is levied by the Central Government on import of goods into, and export of goods from, India.

The term '**customs**' derives its colour and essence from the term 'custom', which means a habitual practice or course of action that characteristically is repeated in like circumstances. Duties on import and export of goods have been levied from time immemorial by all the countries. In India, at the time when the predominant system of governance was monarchy, it was customary for a trader bringing the goods to a particular kingdom to offer gifts to the King for allowing him to sell his goods in that kingdom.

Kautiliya's Arthashastra also refers to 'shulka' consisting of import duty and export duty that was collected at the city gates on goods coming in and going out respectively. Subsequently, the levy of customs duty was organised through legislation during the British period.

Post independence, the Customs Act was passed and promulgated in India by the Parliament in the year 1962. It consolidated the erstwhile Sea Customs Act, 1878, Land Customs Act, 1924 and provisions for air customs. Further, the Customs Tariff Act was passed in the year 1975 to replace the erstwhile Indian Tariff Act, 1934.

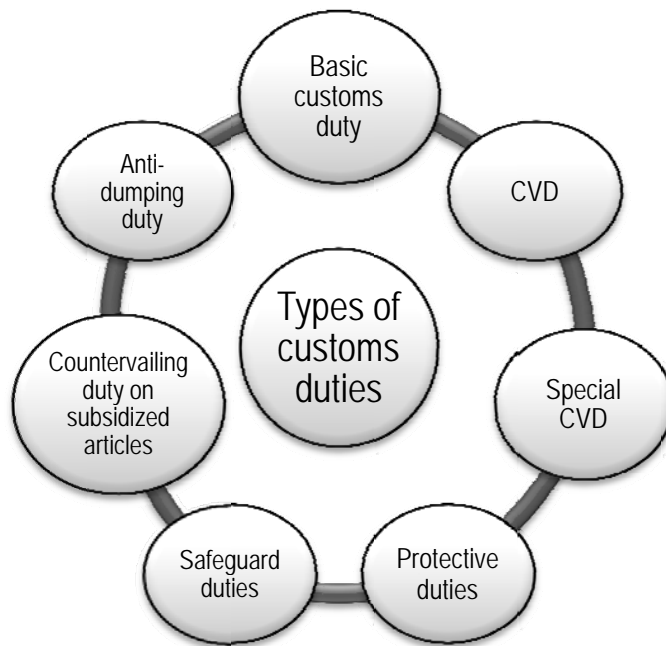
3.2 Constitutional provisions

As learned earlier, customs duty is an indirect tax levied by the Central Government. The power to levy the customs duty is conferred by **Entry 83 of the Union List of the Seventh Schedule** to the Constitution of India.

Entry 83 provides as under:

Duties of Customs including Export duties

The various types of customs duties are as under:-



The aforesaid duties have been elaborated subsequently in this Unit.

3.3 Sources of customs law

Customs Law is a combined study of the Customs Act, 1962, Customs Tariff Act, 1975, Annual Union Finance Acts, Rules, Notifications, Circulars/ Instructions, Trade Notices/Clarifications and Case Laws.

- (1) **Customs Act, 1962:** Customs Act, 1962 contains the provisions governing the import and export duty imposed on imports and exports of the goods.
- (2) **Customs Tariff Act, 1975:** contains the provisions relating to various types of customs duties and the classification of imported and export goods.
- (3) **Rules and regulations:** Some of the rules and regulations issued under the Customs Act, 1962 are the Customs Valuation (Determination of Value of Imported Goods) Rules,

2007, Customs Valuation (Determination of Value of Export Goods) Rules 2007, Baggage Rules, 1998, Export Manifest (Vessels) Regulations, 1976, etc¹.

3.4 Levy of customs duty

(I) Application of the Act

The Customs Act, 1962 applies to the whole of India. India includes territorial waters of India.

Besides, the Customs Act, 1962 and Customs Tariff Act, 1975 have been further extended to:-

- (i) the **notified designated areas** in the Continental Shelf of India (CSI) and Exclusive Economic Zone of India (EEZI) and
- (ii) **whole of EEZI and CSI for the purpose of processing** for extraction or production of mineral oils and supply of any goods in connection thereto.

India has sovereignty in its territorial waters whereas it has full and exclusive economic rights in its EEZ and Continental Shelf.

Example: The machinery purchased by the oil rigs carrying on operations in the EEZI shall be considered as imported goods.

1. **Baseline:** It is the lower water mark along the coast.
2. **Exclusive Economic Zone of India:** It is an area beyond the Indian territorial waters. The limit of exclusive economic zone is 200 nautical miles from the nearest point of the baseline.
3. **Continental Shelf of India:** Continental shelf is the part of the sea floor adjoining a land mass where the depth gradually increases before it plunges into the ocean deeps. Continental Shelf of India extends beyond the limit of its territorial waters throughout the natural prolongation of its land territory to the outer edge of the continental margin or to a distance of 200 nautical miles from the baseline.

- (a) **Indian territorial waters:** Indian territorial waters extend upto 12 nautical miles (22 km) into the sea from the appropriate base line. India includes not only the surface of sea in the territorial waters, but also the air space above and the ground at the bottom of the sea.
- (b) **Indian customs waters:** Indian customs waters means the waters extending into the sea up to the limit of contiguous zone of India and **includes** any bay, gulf, harbour, creek or tidal river [Section 2(28) of the Customs Act, 1962].

Indian customs waters cover both the Indian territorial waters and contiguous zone. Indian territorial waters extend up to 12 nautical miles (nm) from the base line whereas

¹ The other sources relevant for the study of the customs law are similar to the sources of the central excise law. Students are advised to refer Unit-2: Central Excise Duty for detailed discussion on the same.

contiguous zone extend to a further 12 nm from the outer limit of the territorial waters. Therefore, Indian customs waters extend upto a total of 24 nm from base line.

Contiguous zone of India: It is an area 12 nautical miles (nm) beyond the Indian territorial waters. Therefore, it is at a distance of 24 nautical miles from the nearest point of the baseline.

- (c) **Significance of Indian territorial waters and Indian customs waters:** Since India includes Indian territorial waters, all the provisions of the Customs Act and rules and regulations thereunder are applicable in Indian territorial waters. In addition to this, the Customs Act, 1962 has extended certain powers of the customs officers in the Indian customs waters as well (for example, power to stop and search any vessel, power to arrest a person in Indian customs waters etc.).

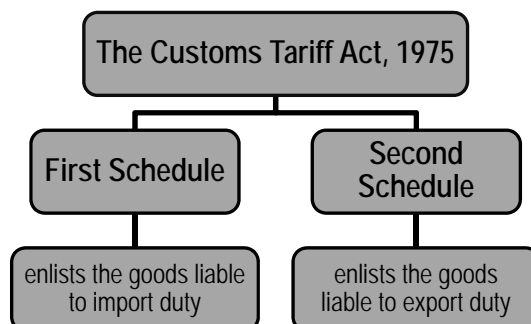
(II) Charging section [Section 12 of the Customs Act, 1962]

1. Except as provided in this Act, or any other law for the time being in force,
 - duties of customs shall be levied
 - at such rates as may be specified under the Customs Tariff Act, 1975, or any other law for the time being in force,
 - on goods imported into and exported from India.
2. The aforesaid provisions shall apply in respect of all goods belonging to Government as they apply in respect of goods not belonging to Government.

However, imports by Indian Navy, specific equipment required by police, Ministry of Defence, Coastal Guard etc. are fully exempt from customs duty by virtue of specific notifications subject to fulfillment of conditions and/or procedure set out in the said notifications.

ANALYSIS : The following propositions arise from the aforesaid section:-

1. Customs duty is charged on goods and not on the person importing them or paying the duty. The goods shall be such as are imported to or exported from India. Being such, it is expected to be passed on to the buyer.
2. It may, however, be noted that this levy is subject to other sections in the Act. For instance:
 - Section 13 – no duty on pilfered goods
 - Section 22 – reduced duty on damaged goods
 - Section 23 – remission of duty on destroyed goods or no duty in case of relinquishment of the title to the goods.
3. Government goods shall be treated at par with non-Governmental goods for the purposes of levy of customs duty.
4. **Rates of duty:** The rates at which duties of customs shall be levied under the Customs Act 1962 are specified in the First and Second Schedules of the Customs Tariff Act, 1975.



- (i) **Preferential rate of duty:** If the goods are imported from the preferential areas [as notified by the Central Government], then a lower preferential rate of duty will be applicable on such goods subject to the fulfillment of specified conditions.
- (ii) **Standard rate of duty:** In any entry, if no preferential rate of duty has been notified, the standard rate of duty shall be applicable.

Determination of duty where goods consist of articles liable to different rates of duty
[Section 19]

Except as otherwise provided in any law for the time being in force, where goods consist of a set of articles, duty shall be calculated as follows: -

- (a) **Articles liable to duty with reference to quantity** (specific duty) shall be chargeable to that duty;
- (b) **Articles liable to duty with reference to value** (ad valorem duty) shall:-
 - (i) if they are liable to duty at the same rate, be chargeable to duty at that rate, and
 - (ii) if they are liable to duty at different rates, be chargeable to duty at the highest of such rates;
- (c) **Articles not liable to duty** shall be chargeable to duty at the rate at which articles liable to duty with reference to value are liable under clause (b).

However, -

- (a) Accessories of, and spare parts or maintenance and repairing implements for, any article which satisfy the conditions specified in the rules made in this behalf shall be chargeable at the same rate of duty as that article;
- (b) If the importer produces evidence to the satisfaction of the proper officer or the evidence is available regarding the value of any of the articles liable to different rates of duty, such article shall be chargeable to duty separately at the rate applicable to it.

(III) Taxable event in case of import of goods into India/export of goods from India

Section 12 makes it abundantly clear that the taxable event for payment of the duty of customs is the importation or exportation of goods into/out of India. However, since India includes

territorial waters of India, even an innocent entry of a vessel into the territorial waters of India might have resulted in import of goods. The confusion in determining the point at which the importation or exportation takes place was cleared by the numerous legal decisions rendered in this regard. The major principles derived by these judgments are as follows:-

(i) **TAXABLE EVENT IN CASE OF IMPORTS**

- (a) **In case of goods cleared for home consumption***: Import of goods commences when they cross the territorial waters, but continues and is completed when they become part of the mass of goods within the country; the taxable event being reached at the time when the goods reach the customs barriers and bill of entry for home consumption is filed.
- (b) **In case of goods cleared for warehousing****: In case of warehoused goods, the goods continue to be in customs bond. Hence, import takes place when the goods are cleared from the warehouse. The customs barriers would be crossed when they are sought to be taken out of the customs and brought to the mass of goods in the country.

***Clearance for home consumption**: It implies that customs duty on imported goods has been paid and thus, goods can be removed by the importer for utilization or consumption within the country.

****Clearance for warehousing**: In case where the goods are not immediately cleared for home consumption, they may be deposited in a warehouse and cleared at a later point of time. In such a case, the collection of customs duty will be deferred till such goods are cleared from warehouse for home consumption.

(ii) **TAXABLE EVENT IN CASE OF EXPORTS**

Export of goods is complete when the goods cross the territorial waters of India. If ship sinks within the territorial waters, export is not complete.

(1) **Goods**: includes-

- (a) vessels, aircrafts and vehicles;
- (b) stores;
- (c) baggage;
- (d) currency and negotiable instruments;
- (e) any other kind of movable property [Section 2(22)].

For anything to be called as goods, it must moveable and marketable. The concept of movability and marketability of goods has been discussed at length in Unit 2: Central Excise Duty.

- (2) **Export:** The term "export", with its grammatical variations and cognate expressions, means taking out of India to a place outside India [Section 2(18)].
- (3) **Export goods:** means any goods, which are to be taken out of India to a place outside India [Section 2(19)].
- (4) **Exporter:** in relation to any goods at any time between their entry for export and the time when they are exported, includes any owner or any person holding himself out to be the exporter [Section 2(20)].
- (5) **Import:** The term "import", with its grammatical variations and cognate expressions, means bringing into India from a place outside India [Section 2(23)].
- (6) **Imported goods:** means any goods brought into India from a place outside India but does not include goods which have been cleared for home consumption [Section 2(25)].
- (7) **Importer:** in relation to any goods at any time between their importation and the time when they are cleared for home consumption, includes any owner or any person holding himself out to be the importer [Section 2(26)].

(IV) Duty to be paid on goods derelict, wreck etc coming into India [Section 21]

All goods, derelict, jetsam, flotsam and wreck brought or coming into India, shall be dealt with as if they were imported into India. Thus, even though such goods had not been actually imported, they would be liable to import duty.

However, if such goods are entitled to be admitted duty-free under this Act, duty would not be levied provided it is shown to the satisfaction of the proper officer that they are so entitled.

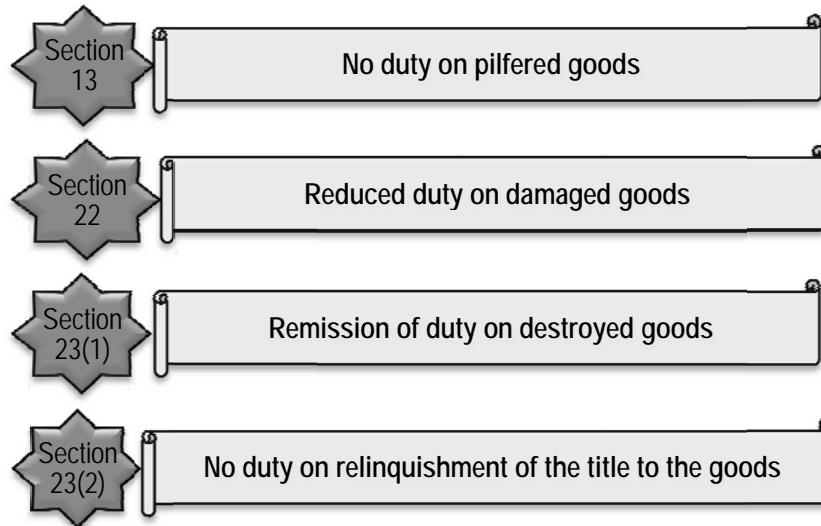
Derelict – This refers to any cargo, vessel, etc. abandoned in the sea with no hope of recovery.

Jetsam – This refers to goods jettisoned from the vessel to save her from sinking.

Flotsam – Jettisoned goods which continue floating in the sea are called flotsam.

Wreck – This refers to cargo or vessel or any property which are cast ashore by tides after ship wreck.

3.5 Customs duty not leviable in certain cases



1. No duty on pilfered goods [Section 13]

If any imported goods are pilfered after the unloading thereof but before the proper officer has made an order for clearance for home consumption or deposit in a warehouse, the importer shall not be liable to pay the duty leviable on such goods. However, where such goods are restored to the importer after pilferage, the importer becomes liable to duty.

Meaning of term 'pilfer': The term 'pilfer' means "to steal, especially in small quantities; petty theft". Therefore, the term does not include loss of total package.

The underlying principle behind this provision is that when the goods are not under the control of the importer, he should not be required to pay duty on such goods.

ANALYSIS:

(a) Conditions to be satisfied for exemption from duty

- The imported goods should have been pilfered.
- The pilferage should have occurred after the goods are unloaded, but before the proper officer makes the order of clearance for home consumption or for deposit into warehouse.
- The pilfered goods should not have been restored back to the importer.

(b) Points which merit consideration

- ✓ If goods are pilfered after the order of clearance is made but before the goods are actually cleared, section 13 is not applicable and thus, duty would be leviable.

- ✓ Section 13 deals with only pilferage. It does not deal with loss/destruction of goods.
- ✓ Provisions of section 13 would not apply if it can be shown that pilferage took place prior to the unloading of goods.
- ✓ In case of pilferage, only section 13 applies and remission of duty under section 23(1) is not permissible.

2. Remission of duty on goods lost or destroyed [Section 23(1)]

Without prejudice to the provisions of section 13, where it is shown to the satisfaction of the Assistant Commissioner of Customs or Deputy Commissioner of Customs that any imported goods have been lost (otherwise than as a result of pilferage) or destroyed, at any time before clearance for home consumption, the Assistant Commissioner of Customs or Deputy Commissioner of Customs shall remit the duty on such goods.

ANALYSIS:

- (a) This section comes into play in case of loss/destruction of imported goods at any time before their clearance for home consumption.
- (b) The remission of duty is permissible only in the case of total loss of goods. This implies that the loss is forever and beyond recovery. The loss referred to in this section is generally due to natural causes like fire, flood, etc. The loss of goods may be at the warehouse also.
- (c) Since section 23(1) is subject to the provisions of section 13, in case the goods have been pilfered after they have been unloaded but before order for clearance for home consumption or deposit in a warehouse, section 13 would apply and the importer would not be liable to pay the duty.

Distinction between section 13 and section 23(1): The provisions of section 13 and section 23(1) can be better appreciated after going through the following points of distinction:-

| Basis | Pilferage of goods under section 13 | Loss or destruction of goods under section 23(1) |
|---------------------------------|---|--|
| Meaning | The word 'pilfer' means to steal, especially in small quantities; petty theft. | The word 'lost' or 'destroyed' refers to total loss of goods i.e. loss is forever and beyond recovery. |
| Duty on goods | Duty is not at all leviable on such goods. | The duty paid on the goods shall be remitted to the importer. |
| Subsequent restoration of goods | Where the pilfered goods are restored to the importer after pilferage, the importer becomes liable to duty. | In case of destruction of goods, the restoration of goods is not possible. |

| | | |
|--|--|--|
| Warehoused goods | Provisions of section 13 are not applicable to warehoused goods. | Provisions of section 23(1) apply to warehoused goods also. |
| Onus to prove the pilferage/destruction or loss of goods | The onus to prove the pilferage does not lie on the importer. | The importer has to prove the loss/destruction to the satisfaction of the Assistant/ Deputy Commissioner of Customs. |
| Time of occurrence of pilferage or loss/destruction | The imported goods must have been pilfered after the unloading thereof and before the proper officer has made an order for clearance for home consumption or deposit in a warehouse. | The imported goods should have been lost/destroyed at any time before clearance for home consumption. |

3. No duty in case of relinquishment of the title to the goods [Section 23(2)]

The owner of any imported goods may, at any time before an order for clearance of goods for home consumption or an order for permitting the deposit of goods in a warehouse has been made, relinquish his title to the goods and thereupon, he shall not be liable to pay the duty thereon.

Meaning of relinquish: "Relinquish" means to give over the possession or control of, to leave off.

However, the owner of any such imported goods shall not be allowed to relinquish his title to such goods regarding which an offence appears to have been committed under this Act or any other law for the time being in force.

ANALYSIS: Sometimes, it may so happen that the importer is unwilling or unable to take delivery of the imported goods. Some of the likely causes may be:

- (i) the goods may not be according to the specifications;
- (ii) the goods may have been damaged or deteriorated during voyage and as such may not be useful to the importer;
- (iii) there might have been breach of contract and, therefore, the importer may be unwilling to take delivery of the goods.

In all the above cases, the goods having been imported, the liability to customs duty is imposed and, therefore, the importer may relinquish his title to the goods unconditionally and abandon them. If the importer does so, he will not be required to pay the duty amount.

However, the owner of any such imported goods shall not be allowed to relinquish his title to such goods regarding which an offence appears to have been committed under this Act or any other law for the time being in force.

It is open to the importer to exercise the above option at any time before the passing of the order for clearance for home consumption or before order permitting the deposit of goods in a warehouse.

4. Abatement of duty on damaged or deteriorated goods [Section 22]

Section 22 provides the importer with an option to pay the reduced duty if the goods are damaged or deteriorated under any of the specified circumstances.

- (a) **Cases where abatement is available:** Abatement is available if it is shown to the satisfaction of the Assistant Commissioner/ Deputy Commissioner of Customs that the goods are damaged/deteriorated under any of the following circumstances:

| S.No. | In case |
|-------|--|
| 1. | any imported goods had been damaged or had deteriorated at any time before or during the unloading of the goods in India |
| 2. | any imported goods, other than warehoused goods, had been damaged on account of any accident, at any time after the unloading thereof in India but before their examination for assessment by the customs authorities |
| 3. | any warehoused goods had been damaged on account of any accident at any time before clearance for home consumption |

Provided such accident is not due to any wilful act, negligence or default of the importer, his employee or agent.

- (1) **Damage:** The term 'damage' denotes physical damage to the goods. This implies that the goods are not fit to be used for the purpose for which they are meant.
- (2) **Deterioration:** Deterioration is reduction in quality of goods due to natural causes.

- (b) **Amount of duty chargeable after abatement:** The duty to be charged on such goods shall bear the same proportion to the duty chargeable on the goods before the damage or deterioration which the value of the damaged or deteriorated goods bears to the value of the goods before the damage or deterioration.

$$\text{Duty to be charged} = \frac{\text{Value of damaged/deteriorated goods*}}{\text{Value of goods before damage/deterioration}} \times \text{Duty on goods before damage/deterioration}$$

Example: If the value of goods is ₹50,000 and after damage the value is ₹10,000 then duty payable on ₹50,000/- should be appropriately reduced to 20% of the duty on such goods before their damage (proportion of 10,000 to 50,000).

- (c) ***Valuation of the damaged or deteriorated goods:** The value shall be:-
- (a) Value ascertained by the proper officer
 - or
 - (b) The proper officer may sell such goods by public auction/tender or if the importer agrees, in any other manner and the gross sale proceeds shall be deemed to be the value of such goods.

3.6 Exemption from customs duty

Central Government's power to grant exemption: Article 265 of the Constitution provides that "No tax shall be levied or collected except by authority of law". The power of the Central Government to alter the duty rate structure is known as delegated legislation and this power is always subject to superintendence and check by the Parliament [Section 25].

- a. **General exemption:** If the Central Government is satisfied that it is necessary in the public interest so to do, it may, by notification in the Official Gazette, exempt generally either absolutely or subject to such conditions (to be fulfilled before or after clearance) as may be specified in the notification, goods of any specified description from the whole or any part of duty of customs leviable thereon.
- b. **Special exemption:** If the Central Government is satisfied that it is necessary in the public interest so to do, it may, by special order in each case, exempt from payment of duty, any goods on which duty is leviable only under circumstances of an exceptional nature to be stated in such order. Further, no duty shall be collected if the amount of duty leviable is equal to, or less than, ₹ 100.

Both the above mentioned exemptions may be granted by providing for the levy of duty on such goods at a rate expressed in a form or method different from the form or method in which the statutory duty is leviable. Further, the duty leviable under such altered form or method shall in no case exceed the statutory duty leviable under the normal form or method.

Rationale for grant of exemption: The power for grant of exemption vests with the Central Government subject to the overall control of the Parliament. The Government on a rational basis may use this power and the exemptions may be based on any of the following factors:

- a. Moral grounds, where the duty should not be levied at all. Some of the instances, which may be given, are;
 - (i) Where the goods do not reach the Indian soil at all.
 - (ii) Where the goods have reached the Indian soil, but are not available for consumption.
 - (iii) Where the goods get damaged or deteriorated in transit.
- b. Discretionary provision, where the exemption is used for controlling the economy and industrial growth of the country.

3.7 Classification of imported/export goods

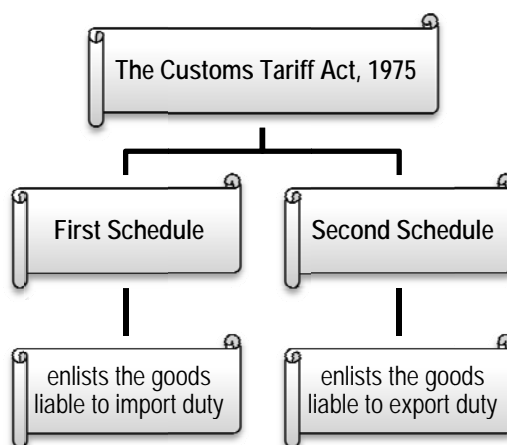
(1) **What is classification?:** Classification of goods under customs consists of determining the headings or sub-headings of the Customs Tariff Act, 1975 (CTA) under which the imported/export goods would be covered.

(2) **Why is classification necessary?:** Classification of imported goods determines (a) rate of applicable duty, (b) applicability of import controls or restrictions, (c) applicability of anti-dumping duty, safeguard duty etc., and (d) benefits of duty exemption notifications.

Unlike in imports, in exports there are no implications of classification on rates of duty except for the very few items on which export duty and cess are payable. However, the correct classification would have implications for grant of export benefits like Drawback.

(3) **What is the scheme of classification?:** The scheme of classification under customs is similar to the one in central excise. The said scheme has been discussed in detail under Unit 2: Central Excise Duty. Just like Central Excise Tariff Act, CTA is also based on the Harmonised System of Nomenclature (popularly known as HSN).

Customs Tariff Act has two schedules:-



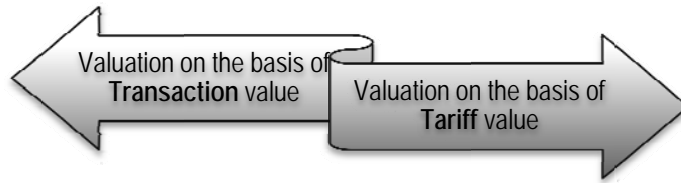
First Schedule to CTA has 21 Sections that contain 98 Chapters. Importer needs to determine the correct classification of the goods imported by him.

3.8 Valuation of imported and export goods

The rates of Customs duties leviable on imported goods and export goods are either specific or on ad valorem basis² or at times on specific cum ad valorem basis.

Section 14 of the Customs Act lays down the basis for valuation of imported and export goods where the customs duties are leviable on ad valorem basis. The value of imported goods and export goods may be determined in any of the following manner:-

² Duty on ad valorem basis is levied as a percentage of the value of the goods.



(I) **VALUATION ON THE BASIS OF TRANSACTION VALUE** [Section 14(1)]

- (a) **Valuation of imported goods:** The value of the imported goods shall be the transaction value of such goods*.

In case of imported goods, the transaction value shall be

- the price actually paid or payable for the goods
- when sold for **export to India**
- for delivery at the time and place of **importation**
- where the buyer and seller of the goods are not related and
- price is the sole consideration for the sale

subject to such other conditions as may be specified in the rules made in this behalf i.e. the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007³.

*The transaction value, in addition to the price as aforesaid, shall include any amount paid or payable for costs and services, including:-

- commissions and brokerage
- engineering
- design work
- royalties and licence fees
- costs of transportation to the place of importation
- insurance
- loading, unloading and handling charges

to the extent and in the manner specified in the Valuation Rules referred above.

- (b) **Valuation of export goods:** As per section 14(1) of the Customs Act, 1962, the value of the export goods shall be the transaction value of such goods.

In case of export goods, the transaction value shall be

- the price actually paid or payable for the goods
- when sold for **export from India**

³ Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 will be discussed in detail at Final Level in Paper 8: Indirect Tax Laws.

- for delivery at the time and place of **exportation**
- where the buyer and seller of the goods are not related and
- price is the sole consideration for the sale

subject to such other conditions as may be specified in the rules made in this behalf i.e. the Customs Valuation (Determination of Value of Export Goods) Rules 2007⁴.

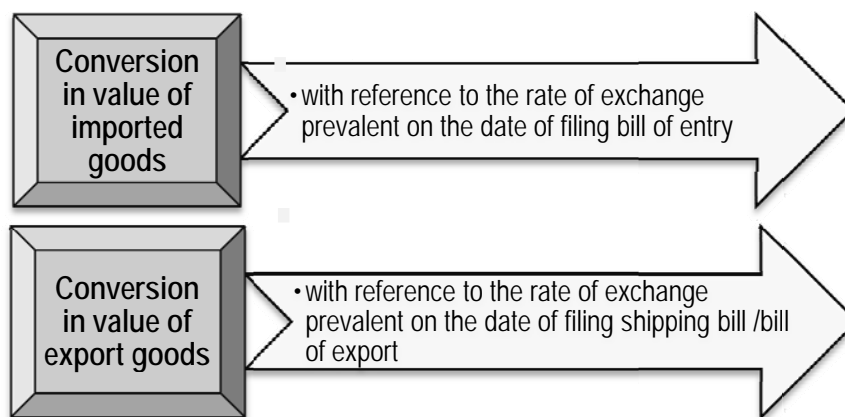
- (II) **VALUATION ON THE BASIS OF TARIFF VALUE** [Section 14(2)]: CBEC may fix tariff values for any class of imported goods or export goods, having regard to the trend of value of such or like goods by notification in the Official Gazette if it is satisfied that it is necessary to do so. Where any such tariff values are fixed, the duty shall be chargeable with reference to such tariff value. Sub-section (2) overrides the provisions of sub-section (1). Tariff values have presently been fixed in respect of import of crude palm oil, crude palmolein, crude soyabean oil, brass scrap, poppy seeds etc.

DATE RELEVANT FOR DETERMINATION OF RATE OF EXCHANGE

The price paid or payable as referred above shall be calculated with reference to the rate of exchange as in force on the date on which a bill of entry in relation to imported goods is presented, or a shipping bill (*in case of export by vessel or aircraft*) or bill of export (*in case of export by vehicle*) in relation to export goods is presented⁵ [Third proviso to section 14(1)].

ANALYSIS

- (1) **For imported goods**, the conversion in value shall be done with reference to the rate of exchange prevalent on the date of filing bill of entry.
- (2) **For export goods**, the conversion in value shall be done with reference to the rate of exchange prevalent on the date of filing shipping bill or bill of export.



⁴ Customs Valuation (Determination of Value of Export Goods) Rules 2007 will be discussed in detail at Final Level in Paper 8: Indirect Tax Laws.

⁵ The concept of presentation of Bill of Entry and Shipping Bill/ Bill of Export has been discussed subsequently in this Unit under the heading of Import and Export Procedures.

Rate of exchange means the rate of exchange —

- (i) determined by the Board, or
 - (ii) ascertained in such manner as the Board may direct,
- for the conversion of Indian currency into foreign currency or foreign currency into Indian currency [Explanation to section 14].

ANALYSIS: The rate of exchange is notified by three agencies- the Central Board of Excise and Customs (Board), the Reserve Bank of India and the Foreign Exchange Dealers' Association of India. For the purpose of valuation under customs, rate notified by Board shall be taken into account. There are separate rates for imported goods (selling rate) and export goods (buying rate).

Example: ABC Manufacturers have imported machinery from US worth \$ 10,000. Determine the rate of exchange for the purpose of computation of customs duty from the following additional information:

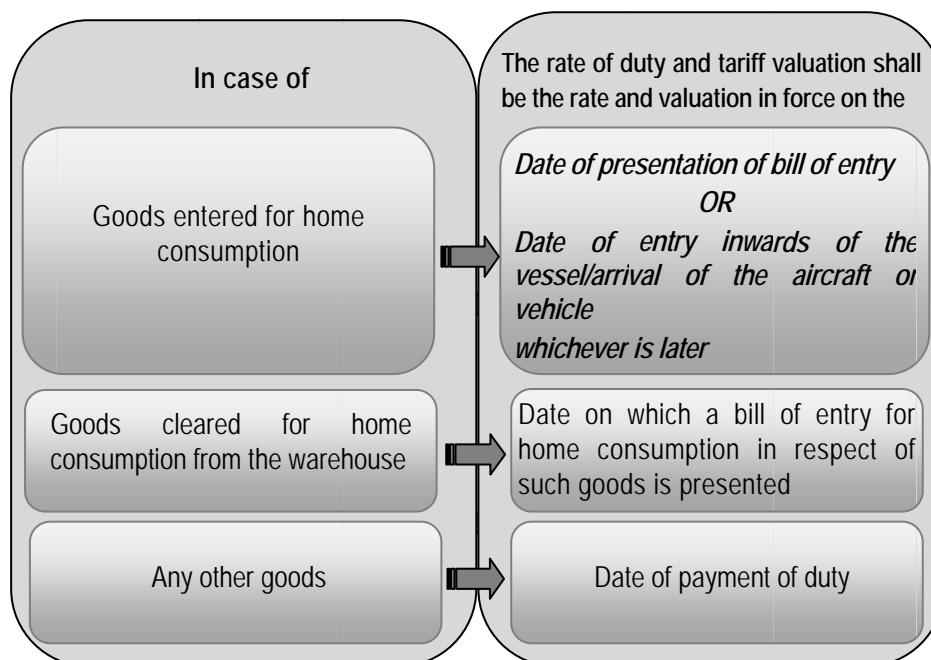
| Particulars | Date | Exchange rate as notified by CBEC | Exchange rate as notified by RBI |
|-----------------------|------------|-----------------------------------|----------------------------------|
| Date of bill of entry | 24.10.2014 | ₹ 68 per US dollar | ₹ 69 per US dollar |
| Date of entry inward | 20.10.2014 | ₹ 70 per US dollar | ₹ 71 per US dollar |

Solution:

Exchange rate in the given case will be the rate of exchange notified by CBEC on the date of presentation of bill of entry i.e. 24.10.2013. Hence, the rate of exchange for the purposes of computation of customs duty will be ₹68 per US dollar.

3.9 Date for determining the rate of duty and tariff valuation of imported goods

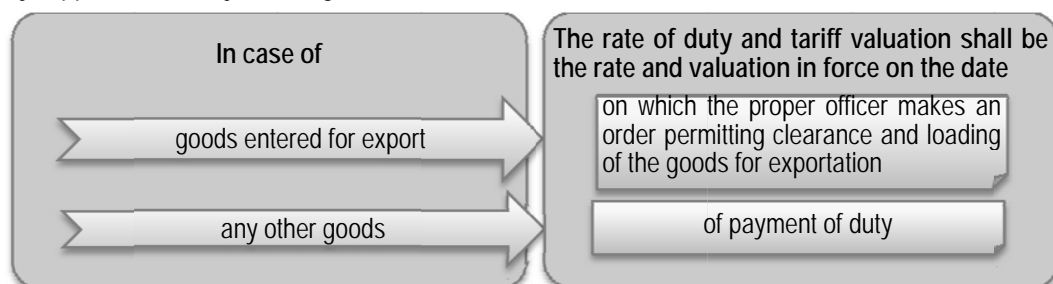
Section 15 prescribes the relevant date for determining the rate of duty and tariff valuation, if any, applicable to any imported goods in the following manner:



Example: Bill of entry is presented on 01.01.2015, the vessel arrives on 03.01.2015. In this situation, relevant date for determination of the rate of import duty is 03.01.2015 because though for procedural purposes, the Bill of Entry was filed on 01.01.2015, for the purpose of determining the rate of duty and tariff valuation of such goods, Bill of Entry will be deemed to have been filed on 03.01.2015.

3.10 Date for determining the rate of duty and tariff valuation of export goods

Section 16 prescribes the relevant date for determining the rate of duty and tariff valuation, if any, applicable to any export goods as under:



Exception: In respect of baggage and goods imported/exported by post, the provisions of section 15 and 16 will not be applicable⁶.

3.11 Types of customs duties

| | |
|--|--|
| 1. Basic customs duty (BCD) | |
| It is the duty | levied under the charging section-section 12 of the Customs Act, 1962 |
| Leviable on | any imported/export goods |
| Rate of duty | as specified in the First and Second Schedules of the Customs Tariff Act, 1975 |
| Assessable value for computing BCD (where duty is leviable on ad valorem basis) | transaction value under section 14(1) /tariff value determined under section 14(2) of the Customs Act, 1962 |
| 2. Additional customs duty under section 3(1) of the Customs Tariff Act, 1975 [also known as Countervailing duty (CVD)] | |
| It is leviable on | any imported article |
| It is the duty equal to | <ul style="list-style-type: none"> excise duty for the time being in force leviable on a like article if produced or manufactured in India. |
| Rate of duty | Rate of excise duty leviable on a like article if produced or manufactured in India** (except in case of alcoholic liquor for human consumption for which rate of additional duty is notified by the Central Government). |
| | <i>Note: EC and SHEC leviable on additional duty of customs are exempt.</i> |
| | <i>**If a like article is not so produced or manufactured in India, rate of duty is the rate of excise duty which would be leviable on the class/description of articles to which the imported article belongs, and where such duty is leviable at different rates, the highest of such rates of duty.</i> |
| 3. CVD under section 3(3) of the Customs Tariff Act, 1975 | |
| Leviable on | any imported article [whether on such article duty is leviable under sub-section (1) or not] |
| It is the duty equal to | additional duty ¹ representing such portion of the excise duty leviable on such raw materials, components and ingredients <i>¹as determined by rules made by the Central Government in this behalf</i> |
| Assessable value for computing CVD under section 3(1) and 3(3) of the Customs Tariff Act, 1975 | |
| In case the duty is charged | Determination of assessable value |

⁶ There are special procedures prescribed for the import/export of baggage and import/export by post. The said provisions will be discussed at the Final Level.

1.68 Indirect Taxes

| on the like article produced/ manufactured in India | |
|---|---|
| (i) On the basis of the tariff value fixed under 3(2) of the Central Excise Act, 1944 | Such tariff value |
| (ii) On the basis of MRP under section 4A | Retail Sale Price (RSP) declared on the imported article |
| | xxx |
| | Less: Abatement notified by Government for like article |
| | xxx |
| (iii) Any other case | Assessable value of the imported article |
| | xxx |
| | <i>Note: Where on any imported article more than one RSP is declared, the maximum of such RSP shall be deemed to be the RSP for the purposes of this section.</i> |
| | Value under section 14(1) /tariff value determined under section 14(2). |
| | xxx |
| | Add: Basic custom duty |
| | xxx |
| | Assessable value |
| | xxx |
| | <i>Note: While computing CVD under sections 3(1) & 3(3), duties leviable under section 8B/8C/9/9A shall not be included.</i> |
| 4. Special CVD under section 3(5) of the Customs Tariff Act, 1975 | |
| It is leviable on | any imported article |
| Purpose of levy of this duty | To counter-balance the sales tax, VAT, local tax or any other charges for the time being in force leviable on a like article on its sale, purchase or transportation in India**. |
| Rate of duty | Rate as notified by the Central Government, but not exceeding 4%. |
| | <i>**If a like article is not so sold, purchased or transported, rate of duty is the rate at which such taxes/charges would be leviable on the class or description of articles to which the imported article belongs, and where such taxes/ charges are leviable at different rates, the highest of such tax/ such charge.</i> |
| Assessable value for computing special CVD under section 3(5) | Value under section 14(1) /tariff value determined section 14(2) |
| | xxx |
| | Add: Basic custom duty |
| | xxx |
| | Add: CVD under section 3(1)/ 3(3) |
| | xxx |
| | Add: Education cess [customs] |
| | xxx |
| | Add: Secondary and higher education cess [customs] |
| | xxx |
| | Assessable value |
| | xxx |
| | <i>Note: While computing special CVD under section 3(5), duties leviable under section 8B/8C/9/9A shall not be included.</i> |

| 5. Education cess (EC) | |
|---|---|
| Levied on | Imported goods |
| Rate of cess | 2% on aggregate of customs duties leviable on such goods |
| Duties to be excluded for computing this cess | Special CVD under section 3(5), duties leviable under section 8B/8C/9/9A and SHEC and EC itself |
| 6. Secondary and Higher Education cess (SHEC) | |
| Levied on | Imported goods |
| Rate of cess | 1% on aggregate of customs duties leviable on such goods |
| Duties to be excluded for computing this cess | Special CVD under section 3(5), duties leviable under section 8B/8C/9/9A and EC and SHEC itself |

Steps for computation of basic customs duty, CVD, special CVD and education cesses:

| S.No. | Particulars | ₹ |
|-------|--|-------------|
| (1) | Assessable value for computing basic customs duty [Transaction value under section 14(1)/Tariff value under section 14(2)] | xxxx |
| (2) | Add: Basic custom duty [(1) × Rate of BCD] | <u>xxxx</u> |
| (3) | Total value for computing additional customs duty u/s 3(1) [(1)+(2)] | xxxx |
| (4) | Additional custom duty u/s 3(1) [(3) × Rate of CVD] | xxxx |
| (5) | Total duty amount for education cess of customs [(2)+(4)] | xxxx |
| (6) | Education cess @ 2% of (5) | xx |
| (7) | Secondary and higher education cess @ 1% of (5) | <u>xx</u> |
| (8) | Total duty payable before additional customs duty u/s 3(5) [(5)+(6)+(7)] | xxxx |
| (9) | Total value for computing additional customs duty u/s 3(5) [(1)+(8)] | xxxx |
| (10) | Additional customs duty u/s 3(5) [(9) × Rate of special CVD] | xxxx |
| (11) | Total duty payable [(8)+(10)] | xxxx |

Example: Compute the customs duty payable from the following information available:-

| | |
|---|-----------|
| Assessable value under section 14 | ₹1,000.00 |
| Rate of basic customs duty | 10% |
| Rate of additional custom duty under section 3(1) | 12% |
| Rate of additional custom duty under section 3(5) | 4% |

| Particulars | ₹ |
|--|---------------|
| Assessable value for computing basic customs duty | 1,000.00 |
| Basic custom duty @ 10% of ₹ 1,000.00 | <u>100.00</u> |
| Total value for computing additional customs duty u/s 3(1) | 1,100.00 |
| Additional custom duty u/s 3(1) [12% of ₹1100](Refer note below) | 132.00 |
| Total duty amount for EC and SHEC [100+132] | 232.00 |

1.70 Indirect Taxes

| | |
|---|----------|
| Education cess @ 2% | 4.64 |
| Secondary and higher education cess @ 1% | 2.32 |
| Total duty payable before additional customs duty u/s 3(5) | 238.96 |
| Total Value for computing additional customs duty u/s 3(5) [₹1,000+₹238.96] | 1,238.96 |
| Additional customs duty u/s 3(5) [₹1,238.96×4%] | 49.56 |
| Total duty payable ₹ [238.96+49.56] (Rounded off) | 289 |

Note: Since, education cess and secondary and higher education cess leviable under sub-section (1) of section 3 of the Customs Tariff Act, 1975 is exempted, rate of additional customs duty has been taken as 12% instead of 12.36%.

Illustration 1:

Hari India Ltd. has imported a machinery whose assessable value is ₹ 1,00,000. Rate of basic customs duty is 10%, additional duty of customs under section 3(1) is 12%, additional duty of customs under section 3(5) is 4% and education cess is 3% on duty. Compute the amount of total customs duty payable by Hari India Ltd.

Solution: Computation of customs duty payable:-

| | Particulars | ₹ |
|----|---|------------------|
| 1. | Assessable Value | 1,00,000.00 |
| 2. | Basic customs duty @ 10% | <u>10,000.00</u> |
| 3. | Sub-Total | 1,10,000.00 |
| 4. | Additional duty of customs (CVD) @ 12% of ₹ 1,10,000 i.e. (₹ 13,200) | 13,200.00 |
| 5. | Education cess 3% of ₹ 23,200 [(2) + (4)] | 696.00 |
| 6. | Total customs duty payable before special CVD [(2) + (4) + (5)] | 23,896.00 |
| 7. | Special CVD@ 4% of [(1)+(6)] | 4,955.84 |
| 8. | Total customs duty payable [(6)+(7)] (Rounded off) | 28,852 |

Illustration 2:

Kalaniketan Enterprises imported some goods from UK. The assessable value of the imported goods is ₹ 20,00,000. Compute the customs duty payable from the following additional information:

| | |
|--------------------------------|---------------------------------|
| Date of bill of entry | 24.10.2013 (Rate of BCD is 10%) |
| Date of entry inward | 20.10.2013 (Rate of BCD is 8%) |
| C.V.D. is payable @ 12% | |
| Special C.V.D. – as applicable | |

Solution:

| Particulars | (₹) |
|---|--------------------|
| Assessable value | 20,00,000.00 |
| Add: Basic custom duty @ 10% (Note below) | <u>2,00,000.00</u> |
| Total | 22,00,000.00 |
| Add: CVD @12% | 2,64,000 |
| Add: Education cess (3% of custom duty) = 3% of (₹ 2,00,000+ ₹ 2,64,000) | 13,920 |
| Total for Special CVD [₹ 22,00,000+₹ 2,64,000+₹ 13,920] | 24,77,920.00 |
| Special CVD @4% | 99,116.80 |
| Total duty payable (₹ 2,00,000+ ₹ 2,64,000+₹ 13,920 + ₹ 99,116.80) | 5,77,036.80 |
| Total duty payable (Rounded off) | 5,77,037 |

Note: The rate of duty shall be:-

- (i) the rate in force on the date of presentation of bill of entry
or
(ii) the rate in force on the date of entry inward
whichever is later.

OTHER CUSTOM DUTIES

- Protective duties:** A duty imposed on imported goods for the protection of the interests of any industry established in India on the recommendation of Tariff Commission. It is effective only and inclusive of the date, if any, specified in the First Schedule of the Tariff [Sections 6 and 7].
- Safeguard duty:** is levied if the Central Government is satisfied that:
 - any article is imported into India in increased quantities; and
 - such increased importation is causing or threatening to cause serious injury to domestic industry.

Safeguard duty is product specific i.e. it is applicable only for certain articles in respect of which it is imposed. This duty is in addition to any other duty levied under this Act or any other law in force. Education cess and secondary and higher education cess is not payable on safeguard duty. The duty imposed under this section shall be in force for a period of 4 years from the date of its imposition and can be extended with the total period of levy not exceeding 10 years. **Safeguard duty shall not apply to articles imported by a 100% EOU/unit in a SEZ unless -**

- (i) specifically made applicable; or

(ii) the article imported is either cleared as such into DTA or used in the manufacture of any goods that are cleared into DTA [Sections 8B].

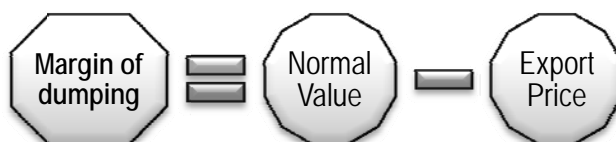
In case the goods are imported in increased quantities from People's Republic of China, a specific safeguard duty is imposed under section 8C.

3. Countervailing duty on subsidized articles: The countervailing duty on subsidized articles is imposed if:-

- (a) Any country or territory, directly or indirectly, pays or bestows subsidy upon the manufacture or production or exportation of any article. Such subsidy includes subsidy on transportation of such article.
- (b) Such articles are imported into India.
- (c) The importation may/may not directly be from the country of manufacture/production and
- (d) The article, may be in the same condition as when exported from the country of manufacture or production or may be changed in condition by manufacture, production or otherwise.

The amount of countervailing duty shall not exceed the amount of subsidy paid or bestowed as aforesaid. This duty is in addition to any other duty chargeable under this Act or any other law for the time being in force. It shall be in force for a period of 5 years from the date of its imposition and can be extended for a further period of 5 years [Section 9].

4. Anti-dumping duty*: Where any article is exported by an exporter to India at less than its normal value, then, upon the importation of such article into India, the Central Government may impose an anti-dumping duty not exceeding the margin of dumping in relation to such article.



The duty imposed under this section shall be in force for a period of 5 years from the date of its imposition and can be extended for a further period of 5 years. The anti-dumping duty shall not be leviable on articles imported by a 100% EOU unless specifically made applicable for such units [Section 9A].

**Note: Dumping occurs when one country exports goods to another country at a price lower than its normal value. This is an unfair trade practice which can have a distortive effect on international trade. Anti dumping duty is a measure to rectify the situation arising out of the dumping of goods and its trade distortive effect.*

3.12 Import and export procedures⁷

IMPORT PROCEDURES

The procedure for importation of goods by air, by sea or by land has been outlined below:-

- (1) **Landing /calling of vessel/aircraft:** In case goods are imported by sea/air, the goods shall be loaded in the vessel/aircraft in the exporting country and sent to India. In case of import by land, the goods shall be sent in a vehicle.

When the vessel/aircraft carrying imported goods arrives in India, the **person-in-charge of such vessel/aircraft** [master/pilot of the vessel/aircraft respectively] entering into India from outside India shall allow calling /landing of the vessel/aircraft only at the customs port/customs airport **unless otherwise permitted by CBEC**.

- (2) **Delivery of import manifest/report:** The person-in-charge of a vessel/aircraft shall deliver to the proper officer an **import manifest** [detailed information about goods in vessel/aircraft] by presenting the same **electronically** before the arrival of the vessel/aircraft at the customs port/customs airport. In case of import by land, the person-in-charge of the vehicle shall deliver to the proper officer an **import report** [detailed information about goods in vehicle] within 12 hours of the arrival of vehicle at the customs station.
- (3) **Grant of Entry Inwards to the master of the vessel/permission to unload the goods:** On receiving import manifest from the master of a vessel, the proper officer shall grant Entry Inwards to the master. The master of the vessel shall not permit the goods to be unloaded until the order of Entry Inwards has been granted by the proper officer to such vessel. Date of Entry Inwards is the date on which the vessel finds a berth place for discharge of cargo.
- (4) **Unloading of goods:** Imported goods shall be unloaded:-
 - (a) only if mentioned in the import manifest/import report.
 - (b) only at the approved places in any customs port/customs airport.
 - (c) under the supervision of the proper officer.
 - (d) during working hours and shall not be unloaded on Sunday/on any holiday.
- (5) **Unloaded goods to be in the custody of the Custodian until their clearance:** Once the imported goods have entered the customs area, they shall remain in the custody of the **Custodian** [a person approved by the Commissioner of Customs for this purpose]. If the imported goods are pilfered after unloading in a customs area, while in the custody of the Custodian, then the Custodian shall be liable to pay duty on such goods.

⁷ The import and export procedures under customs will be discussed in detail at the Final level. In this unit, said procedures have been outlined to familiarize the students with the flow of import and export of goods.

- (6) **Filing of entry for import, i.e. Bill of Entry:** The importer of any goods, other than goods intended for transit or transshipment [*provisions of goods in transit/transshipment are discussed below in point (11)*], shall file a Bill of Entry electronically for clearance of goods from the custom station port/airport. .

In case the goods are to be cleared for home consumption, importer would file Bill of Entry for home consumption. However, if the importer does not need the goods immediately, he may request the goods to be warehoused. In that case, an Into-Bond Bill of Entry (for warehousing) would be filed. When subsequently, the goods are clearance from warehouse for home consumption, an Ex-Bond Bill of Entry is required to be filed.

Timing of filing of Bill of Entry: A Bill of Entry may be presented at any time after the delivery of the Import Manifest/Import Report. *However, a bill of entry may be presented even before the delivery of such Import Manifest/Import Report if the vessel or the aircraft or the vehicle by which the goods have been shipped for importation into India is expected to arrive within 30 days from the date of such presentation.*

- (8) **Assessment of duty on the imported goods:** Assessment is the procedure of quantifying the amount of liability. The importer will self-assess the duty considering the applicable rate of exchange and rate of import duty. This self-assessment is subject to verification by the proper officer of the Customs and may lead to reassessment by such officer if the assessment made by the importer is found to be incorrect. The proper officer shall return the Bill of Entry to the importer after determination of the duty amount.
- (9) **Payment of duty:** If the goods are cleared to be stored in a warehouse, payment of duty is deferred till the time of clearance from such warehouse. However, in case the goods are cleared for home consumption, customs duty has to be paid.

The importer has to pay the duty within **2 days** (excluding holidays) of the determination of such duty amount. In case he fails to do so, he is required to pay interest on the duty till the time he actually pays the duty and clears the goods.

- (10) **Clearance of imported goods from the custom station:** The goods lying under the custody of the custodian have to cleared either for home consumption or for warehousing or for transshipment within **30 days** (or such extended time as the proper officer may allow) from the date of unloading of goods at the customs station. The importer may exercise any of the following options:-
- (a) **Clearance for home consumption:** In case the importer files the Bill of Entry for home consumption and the proper officer is satisfied that the imported goods are not prohibited goods and duty on the same has been paid, he may make an order permitting clearance of the goods for home consumption.
 - (b) **Warehousing of imported goods:** The importer may not clear the goods for home consumption and request the goods to be warehoused. In such a case, he shall file an Into-Bond Bill of Entry for warehousing and is assessed to duty. Thereafter, he shall execute a bond binding himself in a sum equal to twice the amount of the duty

assessed on such goods. The proper officer after satisfying himself that all the requirements have been fulfilled shall make an order permitting the deposit of the goods in a warehouse.

Subsequently, the importer of any warehoused goods may clear them for home consumption provided:-

- (i) an ex-Bond Bill of Entry has been presented to the proper officer and duty is assessed and paid by him
- (ii) rent and warehousing charges along with any penalty on warehoused goods, if any, have been paid by importer, and
- (iii) an order for clearance of such goods for home consumption has been made by the proper officer.

(11) Imported goods in transit or transshipment:

Transit of goods: Where any goods (not being prohibited goods) which are imported in a conveyance are mentioned, in the import manifest/import report, as for transit in the same conveyance to any place outside India or any customs station, they may be allowed to be so transited without payment of duty.

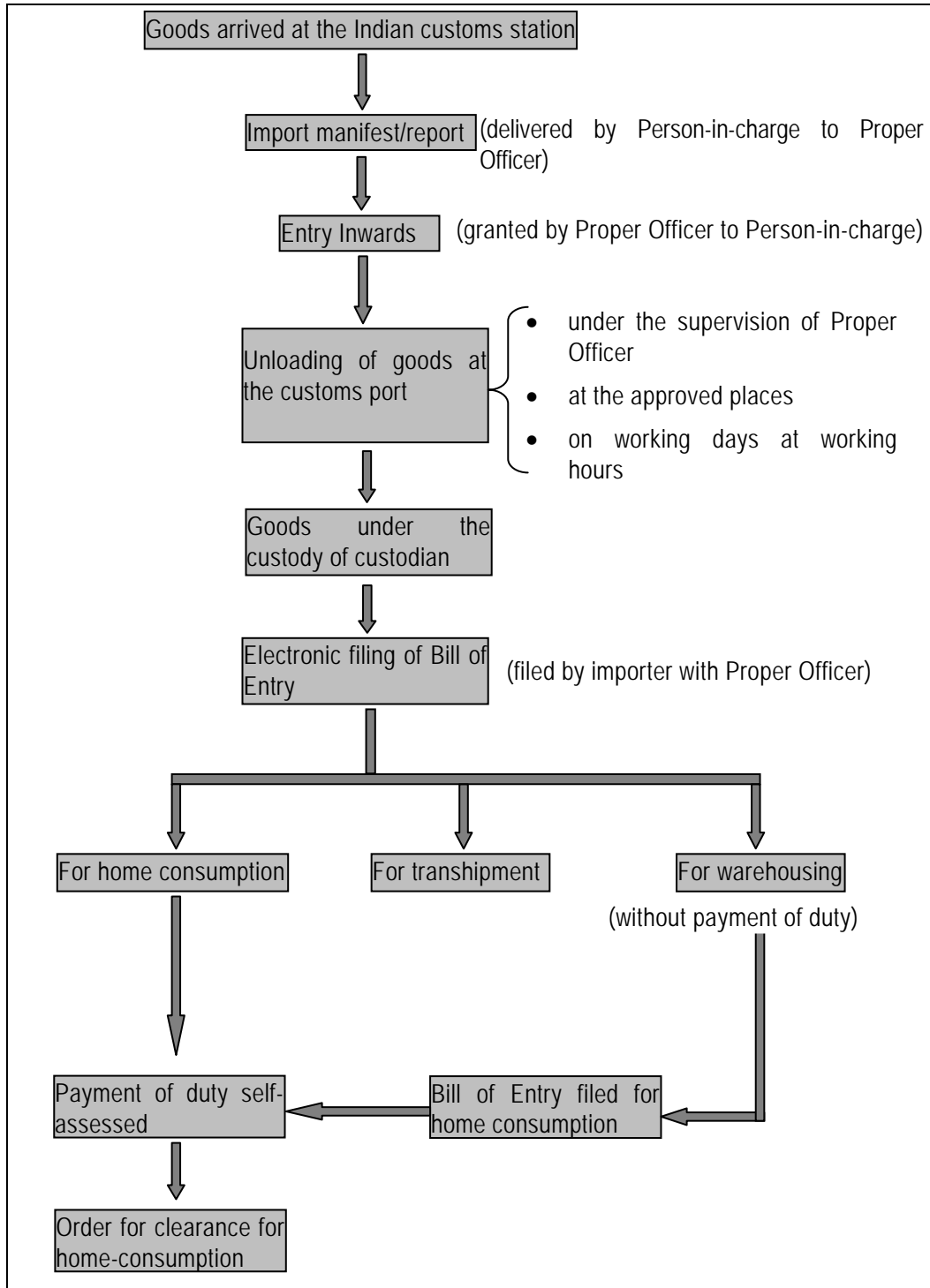
Transshipment of goods: Where any goods (not being prohibited goods) which are imported in a conveyance are mentioned, in the import manifest/import report, as for transshipment to any place outside India or to any major port/other port as notified /any other customs station, they may be allowed to be so transhipped without payment of duty. The importer shall present the Bill of Entry for transshipment to the proper officer.

Unlike transit under transshipment, goods are transferred from one conveyance to another.

1. **Conveyance:** includes:-
 - (a) a vessel
 - (b) an aircraft and
 - (c) a vehicle [Section 2(9)].
2. **Vehicle:** means conveyance of any kind used on land and includes a railway vehicle [Section 2(42)].
3. **Customs station:** means any customs port, customs airport or land customs station [Section 2(13)].

***Note:** There are separate import procedures for import of baggage and import by post. The same will be discussed at Final level in Paper 8: Indirect Tax Laws.*

The brief procedure for import of goods has been depicted in the diagram below:-



EXPORT PROCEDURES

The procedure for exportation of goods by air, by sea or by land has been outlined below:-

- (1) **Filing of shipping bill/ bill of export:** The exporter is required to present electronically to a proper officer of customs a **shipping bill** [in case of export by a vessel or by air] and a **bill of export** [in case of export by a vehicle].

An exporter entering any export goods self-assesses and pays the duty, if any, leviable on such goods subject to verification by the proper officer.

- (2) **Order permitting clearance and loading of goods for exportation:** Where the proper officer is satisfied that:

- goods entered for export are **NOT prohibited goods and**
- exporter has **paid duty, if any**, on them,

he passes order permitting clearance and loading of goods for exportation called Let Export Order.

- (3) **Grant of Entry Outwards:** A vessel intending to start loading of export goods must be first granted an 'Entry Outwards' by the proper officer. The master of a vessel shall not permit the loading of any export goods, until the proper officer grants entry-outwards to such vessel.

Note: Entry outwards is the permission granted by the Customs authorities to a vessel to go on a foreign voyage to the port of consignment.

- (4) **Loading of goods on conveyance for exportation:** The export goods shall be loaded on the conveyance for exportation with the permission of person-in-charge. He shall not permit the loading at a customs station unless a shipping bill/bill of export/bill of transshipment, as the case may be, duly passed by the proper officer, has been handed over to him by the exporter.

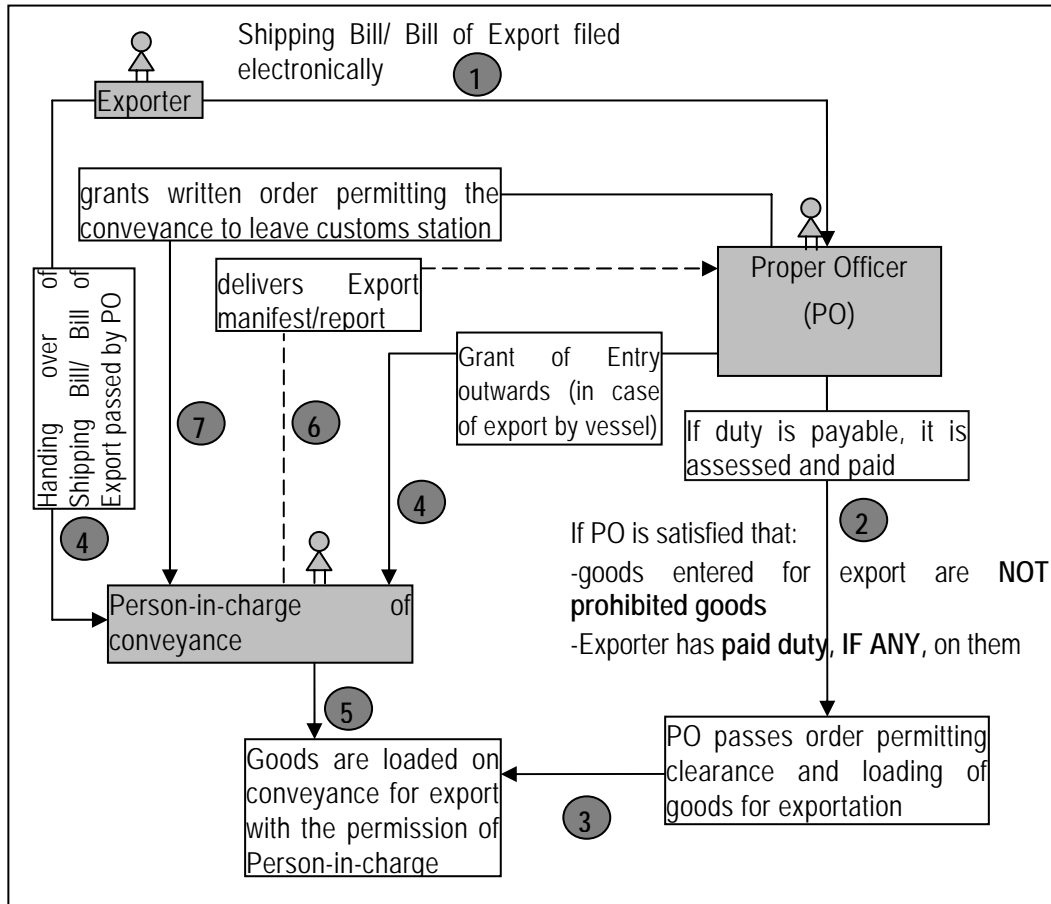
Note: In case of goods exported in a vessel, grant of entry outwards is also mandatory requirement before loading of goods.

- (5) **Delivery of export manifest/report:** The person-in-charge of a conveyance carrying export goods shall, before departure of the conveyance from a customs station, deliver to the proper officer in the case of a vessel or aircraft, an export manifest **electronically**, and in the case of a vehicle, an export report.

- (6) **No conveyance to leave without written order:** The person-in-charge of a conveyance which has loaded any export goods at a customs station shall not cause or permit the conveyance to depart from that customs station until a written order to that effect has been given by the proper officer.

Note: There are separate export procedures prescribed for export of baggage and export by post. The same will be discussed at Final level in Paper 8: Indirect Tax Laws.

The brief procedure for export of goods has been depicted in the diagram below:-



Note: The rates of duties, wherever mentioned in the illustrations may not always be the actual rate prevalent during the period in question. They may be hypothetical rates assumed to explain the provisions of law with more clarity.

UNIT – 4: CENTRAL SALES TAX

Learning objectives

After reading Unit- 4 of this Chapter, you will be able to understand:

- ◆ the concept of sale
- ◆ historical background of central sales tax
- ◆ objects of the Central Sales Tax Act, 1956
- ◆ the Constitutional provisions relating to central sales tax
- ◆ the provisions relating to levy and collection of central sales tax
- ◆ as to what is an inter-State sale
- ◆ sales tax implications on inter-State stock transfer/consignment transfer
- ◆ as to what is a sale outside the State
- ◆ as to what is sale in course of import and export
- ◆ how to determine the applicable rates of central sales tax on the sales in the course of inter-State trade or commerce
- ◆ how to determine the turnover for computing central sales tax
- ◆ provisions relating to the goods of special importance

Apart from the above, after you finish reading this Unit, you will also get a brief idea of the forms and procedures under the central sales tax law.

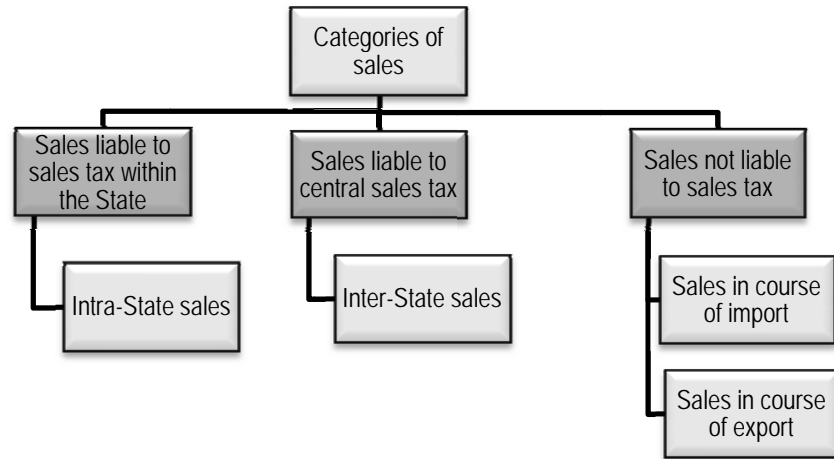
4.1 Categories of sales

Sales may be classified as:-

- (i) Intra-State sales
- (ii) Inter-State sales
- (iii) Sales in course of import
- (iv) Sales in course of export¹

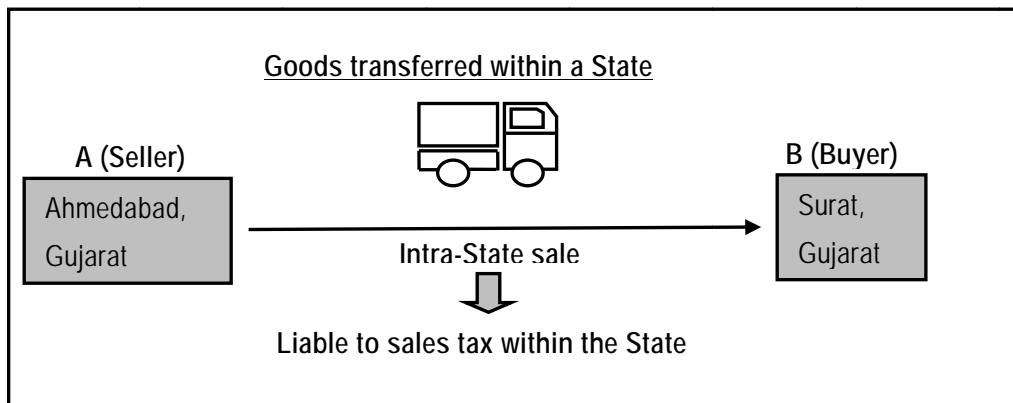
Central Sales Tax (CST) is a tax imposed on inter-State sales, i.e. sales made from one State to another whereas sales tax within the State is levied on the intra-State sales, i.e. sales made within a State. Sales made in course of imports and sales in course of export are not liable to sales tax.

¹ Sales in course of import and export have been explained subsequently in this Unit.

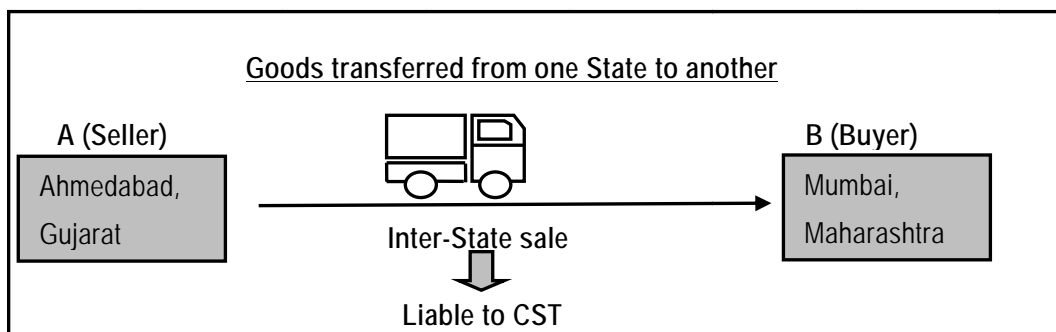


Examples depicting distinction between intra-State sales and inter-State sales

(I) INTRA-STATE SALES



(II) INTER-STATE SALES



4.2 Constitutional provisions

Intra-State sale is within the authority of the State Government² while inter-State sale is within the authority of the Central Government. Central Government levies central sales tax by drawing power from Entry 92A of the Union List which provides as follows:-



It is important to note here that power to impose tax on sale of newspapers has been specifically excluded from the purview of the powers of the Central Government.

4.3 Sources of central sales tax law

Central sales tax law is a combined study of the Central Sales Tax Act, 1956, Annual Union Finance Acts, Rules, Notifications, Circulars/ Instructions, Trade Notices/Clarifications and Case Laws.

- (1) **Central Sales Tax Act, 1956:** Central Sales Tax Act, 1956 contains the provisions governing the sales tax imposed on inter-State sales, i.e. sales made from one State to another.
- (2) **Rules:** The rules issued under the Central Sales Tax Act, 1956 are the Central Sales Tax (Registration and Turnover) Rules, 1957³.

4.4 Historical background of central sales tax

A transaction of sales of goods has various ingredients, namely, contract of sale, consideration, transfer of property in goods and buyer and seller. For the purposes of levying sales tax, prior to adoption of Constitution, States selected any one of the foregoing ingredients and acting on the theory of territorial nexus* levied sales tax on a transaction if that ingredient exists in their State. Resultantly, same transaction got taxed in more than one State.

**Nexus' means connection or link.*

In order to resolve this problem, when Constitution was adopted, article 286 was introduced. Explanation to clause (a) of Article 286(1) provided that a sale or purchase shall be deemed to

² Sales tax within the State is levied by State Government by virtue of Entry 54 of the State List i.e. "Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of Union List".

³ The other sources relevant for the study of the central sales tax law are similar to the sources of the central excise law. Students are advised to refer Unit-2: Central Excise Duty for detailed discussion on the same.

1.82 Indirect Taxes

have taken place in the State in which the goods have actually been delivered as a direct result of such sale or purchase for the purpose of consumption in that State.

However, Supreme Court, in case of *Bengal Immunity Co. Ltd. v. State of Bihar* 1955 6 STC 446 616 (SC) elucidated that State cannot impose tax on inter-State sales as Article 286(2) prohibits the State from imposing tax on the sale of goods where such sale takes place in the course of inter-State trade or commerce subject to the removal of ban by legislation made by Parliament. Since Parliament had not passed any such law, no State can impose tax on inter-State sales.

The net result was that while intra-State sales could be taxed under the relevant State law, inter-State sales could neither be taxed by the State of despatch nor by the State of delivery until the Parliament provided for it.

On April 1, 1953, Taxation Enquiry Commission was appointed to set out basic considerations for the future development of the sales tax. In the light of the suggestions made by said Commission, the Constitution was amended. As a result:

1. Article 269(1)(g) was inserted to enlarge the powers of the Government of India. It provided that Government of India shall levy and collect taxes on the sale or purchase of goods other than newspapers where such sale or purchase takes place in the course of inter-state trade or commerce. However, it also provided for the assignment of such taxes to the States in the prescribed manner. Further, a new clause (3) was inserted in Article 269 whereby the Parliament was empowered to formulate principles for determining when a sale or purchase of goods takes place in the course of inter-state trade or commerce.
2. Article 286 was amended to provide as follows:
 - i. No law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place—
 - a. outside the State or
 - b. in the course of the import of the goods into, or export of the goods out of, the territory of India.
 - ii. Parliament may by law formulate principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in clause (1) namely, sale or purchase of goods outside the State or in the course of the import into or export out of territory of India⁴.
 - iii. Any law of a State shall, in so far as it imposes, or authorises the imposition, of a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce, be subjected to such restrictions and

⁴ Section 4 & 5 of the Central Sales Tax Act, 1956 are in exercise of the powers conferred under this clause [discussed in detail subsequently in this Unit].

conditions in regard to the system of levy, rates and other incidents of the tax, as Parliament may, by law, specify⁵.

Acting on the powers thereby conferred, the Central Sales Tax Act, 1956 was enacted by the Parliament.

4.5 Objects of the Central Sales Tax Act

The objects of the Central Sales Tax Act include:

- (i) formulation of principles for determining as to:-
 - (a) when a sale or purchase of goods takes place in the course of inter-State trade or commerce, or
 - (b) when a sale or purchase takes place outside a State, or
 - (c) when a sale or purchase takes place in the course of import into or export from India
- (ii) provision for the levy, collection and distribution of taxes on sales of goods in the course of inter-State trade or commerce
- (iii) declaration of certain goods to be of special importance in inter-State trade or commerce
- (iv) State laws to be subjected to the restrictions and conditions in the matter of imposing taxes on the sale or purchase of goods declared by the Central Government to be of special importance.

4.6 Levy and collection of central sales tax

Central Sales Tax Act, 1956 extends to whole of India. Section 9(1) contains the provisions regarding levy and collection of CST as under:-

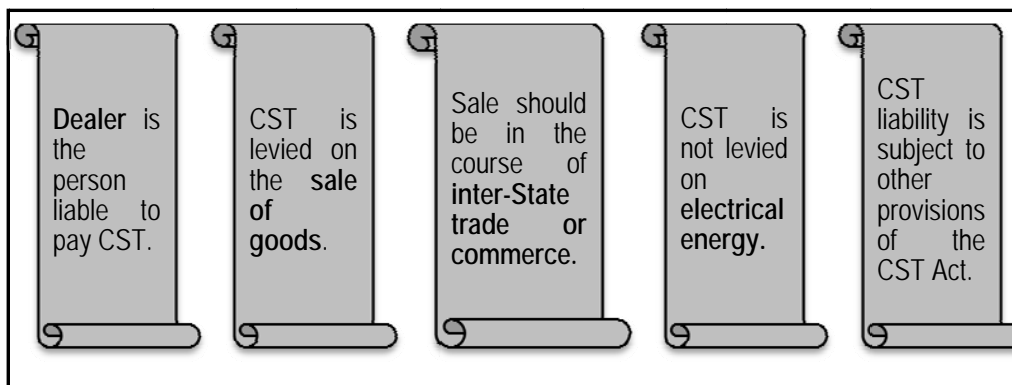
- (i) **Levy:** Being a Central legislation, CST payable by any dealer on sales of goods effected by him in the course of inter-State trade or commerce shall be levied by the Government of India.
- (ii) **Collection:** CST so levied shall be collected by State Government of the State from which the movement of the goods is commenced.

4.7 Charge of central sales tax

Section 6(1) provides that subject to the other provisions contained in the Central Sales Tax Act, every dealer shall be liable to pay tax under this Act on sales of all goods, other than electrical energy, effected by him in the course of inter-State trade or commerce during any year.

CST is leviable on inter-State sale of any goods even if sale of such goods **inside a State** is exempt as per the sales tax law of that State.

⁵ Section 14 & 15 of the Central Sales Tax Act, 1956 are in exercise of the powers conferred under this clause [discussed in detail subsequently in this Unit].



IMPORTANT TERMS

1. Goods

Goods include all materials, articles, commodities and all other kinds of movable property, but does not include newspapers, actionable claims, stocks, shares and securities [Section 2(d)].

ANALYSIS: As per the definition of goods, they must be movable, i.e. they include all kind of movable property. However, following are specifically excluded from the definition of goods:-

- (i) **Newspapers:** Newspapers are not goods under the Central Sales Tax Act and State VAT laws. Although in general sense, newspapers are goods, but they have been specifically excluded from the definition of goods in view of Entry 92A of the Union List and Entry 54 of the State List. In both these entries, newspapers have been specifically excluded from the purview of taxes on inter-State sales and intra-State sales respectively.

Note: Sale of bundles of old newspapers as waste paper is not sale of newspaper and is therefore, not exempt.

- (ii) Stocks, shares and securities

- (iii) **Actionable claims:** are outside the purview of definition of goods under CST Act. Actionable claim means a claim to any debt, other than a debt secured by mortgage of immovable property or by hypothecation or pledge of movable property, or to any beneficial interest in movable property not in the possession, either actual or constructive, of the claimant, which the civil courts recognise as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, conditional or contingent [Section 3 of the Transfer of Property Act, 1882]. For example, a claim for arrears of rent, right to claim provident fund, lottery tickets, etc.

Note: **Electricity** is capable of abstraction, consumption and use and it can be transmitted, transferred, delivered, stored, possessed, etc. and is, therefore, goods. However, it is important to note that although electricity is goods, it has specifically been excluded from the purview of CST by the charging section.

2. Sale

Sale, with its grammatical variations and cognate expressions, means any transfer of property in goods by one person to another for cash or deferred payment or for any other valuable consideration, and includes,–

- (i) a transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;
- (ii) a transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;
- (iii) a delivery of goods on hire-purchase or any system of payment by instalments;
- (iv) a transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;
- (v) a supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;
- (vi) a supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration,

but does not include a mortgage or hypothecation of or a charge or pledge on goods [Section 2(g)].

ANALYSIS: The definition of sales may be read in two parts:-

- (A) Conventional sale
- (B) Deemed sales

(A) CONVENTIONAL SALE: Sale means any transfer of property in goods by one person to another for cash or deferred payment or for any other valuable consideration, but does not include a mortgage or hypothecation of or a charge or pledge on goods.

Essential elements of a conventional sale are as follows:-

- (I) There must be a contract of sale between **buyer and seller**.
- (II) There must be transfer of **goods**.
- (III) General **property in goods must be transferred** from buyer to seller.
- (IV) **Consideration** must be paid or agreed to be paid. It may be cash or deferred payment or for any other valuable consideration.



(B) DEEMED SALES: There are some transactions which may not be termed as sales because either of the essential elements of the sale is absent. However, by virtue of Article 366(29A) of the Constitution, such transactions have been deemed as sales. These are:-

- (i) **Compulsory sales:** In case of compulsory sales, there is a compulsory transfer of goods under the Government orders, i.e. where goods are a controlled commodity. In such cases, there is no mutual consent between buyer and seller. The seller is under an obligation to sell the goods on the order of the controlling authorities at the controlled prices.

However, as per the conventional definition, there must be a contract between two parties and there should be mutual consent between them for a sale transaction to fructify. Section 2(g)(i) of the Act makes sales tax payable on such a sale even though there is no contract between two parties.

- (ii) **Sale of goods involved in the execution of works contract:** One of the essential elements of sale is that there should be sale of goods. Since works contract involves both sale of goods and provision of services, as per the conventional definition, sales tax could not be levied on it.

Section 2(g)(ii) makes CST payable on the value of goods involved in the inter-State works contract whereas on the value of services, service tax shall be payable.

Guidelines to ascertain whether a transaction is a works contract: To ascertain whether a transaction is a works contract as contemplated in Article 366(29A)(b), the following points should be kept in mind:

1. There must exist an indivisible works contract; divisible contracts are outside the scope.
2. Goods must be involved in the execution of the works contract.
3. Transfer of property must be an integral part of its execution. Property in goods must pass either as goods or in some other form. Form of goods is irrelevant for determination of rate of tax.
4. Property in goods must be transferred during the execution of works not before or after the execution of works.

5. If during the execution of works contract, goods are consumed and their identity is lost, then no transfer of property occurs in those goods.
6. Some work has to be done on the property of the contractee by the contractor.
7. Pure labour contracts or service contracts are outside the purview of the sales tax law.
8. There must be a dominant intention to effect the transfer of property in goods in execution of works contract. However, even if the dominant intention of the contract is rendering of a service and in that process if there is a transfer of property in goods, the contract will amount to a works contract. Building contract is 'works contract'. Painting or printing is also a 'works contract'.
9. Job work or processing is 'works contract' if property in goods passes to customer during job work.

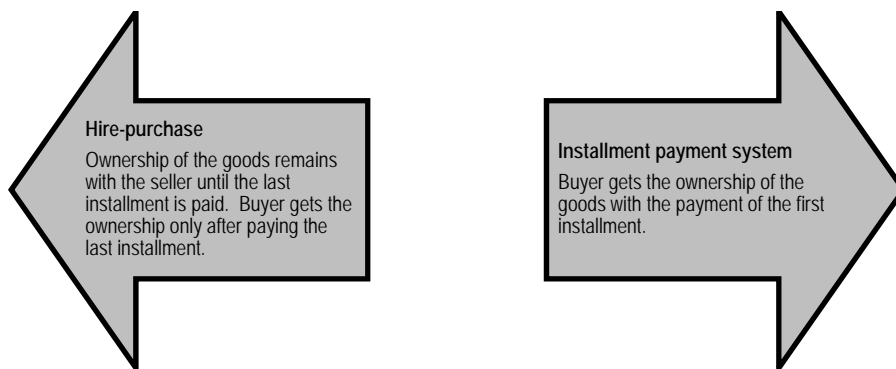
Note: There can be inter-state sale of goods in works contract and C form can be issued/ received. CST is levied on 'goods involved in the works contract and not on the works contract'.

Works contract means a contract for carrying out any work which includes assembling, construction, building, altering, manufacturing, processing, fabricating, erection, installation, fitting out, improvement, repair or commissioning of any movable or immovable property [Section 2(ja)].

- (iii) **Hire-purchase or any system of payment by installments:** As per clause (iii) of section 2(g) of CST Act, 'sale' includes a delivery of goods on hire-purchase or any system of payment by installments.

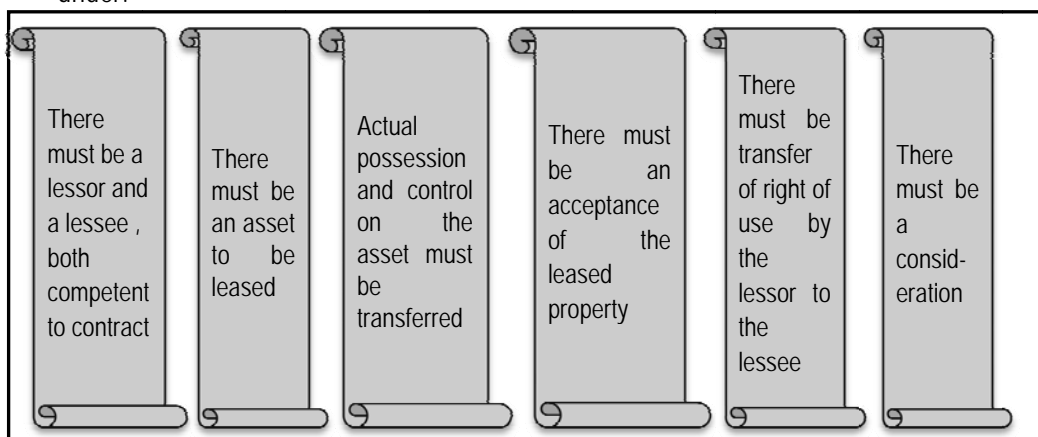
Hire purchase is one of the modes of financing an asset. Hire- purchase agreement means an agreement under which owner of the goods let out them on hire to the hirer. Under this transaction, the hirer acquires the possession of goods immediately on signing the hire purchase agreement, but the property in the goods passes to hirer only when the last installment is paid. If the hirer fails to pay any of the installments, the owner takes the asset back without any refund of the earlier installments.

Under installment payment system, the ownership of the goods is passed immediately on payment of the first installment.



- (iv) **Lease transactions:** Section 2(g)(iv) covers a sale where property in goods is not transferred; only right to use is transferred. Thus, it makes sales tax payable on the lease transactions.

A lease is a special type of transaction, under which a party owning the asset (called the 'lessor') provides that asset for use over a certain period of time to another party (called the 'lessee') for consideration (called 'rentals'). The **legal ownership of the asset remains with the lessor**, but the lessee retains the possession and uses the asset over the period of the lease. Therefore, the characteristics of a lease can be summarized as under:-



Generally, there are two different types of leases:

Finance lease: Here the lessor provides finance to the lessee for the purchase of necessary equipments. Machinery and tools, intended to be purchased are purchased in the name of the lessor, but the right to select the assets rests with the lessee. Lessor's interest in the equipment is that of ownership and the rent received or receivable against such lease. After the end of lease period, the lessee has an option to purchase the leased asset. As per the Accounting Standard (AS 19) on leases issued by the ICAI, a finance lease is a lease that transfers substantially all the risks and rewards incidental to the ownership of an asset.

Operating lease: Here the lessor selects the machinery and equipment required to be purchased and then leases out the same to the customer. The ownership is retained by the lessor, but the use of the assets by the lessee is made for a limited period of time. The AS 19 on Leases defines an operating lease as a lease other than a finance lease.

- (v) **Sale of goods by any unincorporated association or body of persons to a member:** For sale, there must be distinct buyer and seller. The seller cannot sell the goods to himself. An unincorporated association or body of persons is not a distinct entity from its members. Thus, in case of goods sold by unincorporated association or body of persons to a member, the element of the sale that buyer and seller must be distinct, is absent. Article 366(29A)(e) has empowered the Parliament to tax this transaction and thus this clause has been inserted in the definition of sale.

- (vi) **Sale of food articles:** As per section 2(g)(vi), sale includes a supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration.

Background for levy of sales tax on deemed sales

Sales tax laws enacted by various States proceeded on the footing that the expression 'sale of goods' would be given a wide expression since it related to entries in the legislative lists.

However, in *Gannon Dunkerley's case (AIR 1958 SC 560)*, the Supreme Court held that the expression 'sale of goods' would have the same meaning as it had in the Sale of Goods Act, 1930. As a result of this decision, a transaction, in order to be subject to the levy of sales tax under Entry 92A of the Union List or Entry 54 of the State List should have the essential ingredients namely, parties competent to contract, mutual assent and transfer of property in goods from one of the parties to the contract to the other party thereto for a price.

Subsequently, in a number of judgments, Supreme Court held various transactions which in substance, resemble the sale transaction but where one or other element of sale is absent, to be not liable to sales tax (few examples have been discussed below). This position resulted in the scope for avoidance of tax in various ways.

For example, in case of an indivisible works contract, it is not possible to levy sales tax on the transfer of property in the goods involved in the execution of such contract as it has been held that there is no sale of the materials as such and the property in them does not pass as movable.

Though in practice, the purchaser in a hire purchase agreement gets the goods on the date of hire purchase, it has been held that there is sale only when the purchaser exercises the option to purchase at a much later date and therefore, only the depreciated value of the goods involved in such transaction at the time the option to purchase is exercised becomes assessable to sales tax.

Similarly, sales by an unincorporated club or association of persons to its members is not taxable as such club has no separate existence from that of the members.

In another famous judgment, the Supreme Court held that there is no sale involved in the supply of food or drink by a hotelier to a person lodged in the hotel.

The aforementioned problems connected with the power of the States to levy tax on the sale of goods and with the levy of CST, were referred to the Law Commission which recommended that certain amendments should be made in the Constitution to overcome the problems created by the above judicial decisions. Consequently, the Constitution (46th Amendment) Act, 1982 was passed and a new clause (29A) was inserted in Article 366 which empowered both Government of India as well as State Governments to levy tax on such transactions. As per Article 366(29A) of the constitution; "tax on the sale or purchase of goods" includes—

- (a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;

- (b) a tax on the transfer of property in goods (whether as goods or in some other form) invoked in the execution of a works contract;
- (c) a tax on the delivery of goods on hire purchase or any system of payment by installments;
- (d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;
- (e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;
- (f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration, and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made.

3. Dealer

Dealer means any person who carries on (whether regularly or otherwise) the business of buying, selling, supplying or distributing goods, directly or indirectly, for cash, or for deferred payment, or for commission, remuneration or other valuable consideration, and includes-

- (i) a local authority, a body corporate, a company, any cooperative society or other society, club, firm, Hindu undivided family or other association of persons which carries on such business;
- (ii) a factor, broker, commission agent, del credere agent, or any other mercantile agent, by whatever name called, and whether of the same description as hereinbefore mentioned or not, who carries on the business of buying, selling, supplying or distributing, goods belonging to any principal whether disclosed or not; and
- (iii) an auctioneer who carries on the business of selling or auctioning goods belonging to any principal, whether disclosed or not and whether the offer of the intending purchaser is accepted by him or by the principal or a nominee of the principal.

Explanation 1 - Every person who acts as an agent, in any State, of a dealer residing outside that State and buys, sells, supplies, or distributes, goods in the State or acts on behalf of such dealer as-

- (i) a mercantile agent as defined in the Sale of Goods Act, 1930, or
- (ii) an agent for handling of goods or documents of the title relating to goods, or
- (iii) an agent for the collection or the payment of the sale price of goods or as a guarantor for such collection or payment, and every local branch or office in a State of a firm registered outside that State or a company or other body corporate, the principal office or headquarters whereof is outside that State, shall be deemed to be a dealer for the purposes of this Act.

Explanation 2 - A Government which, whether or not in the course of business, buys, sells, supplies or distributes, goods, directly or otherwise, for cash or for deferred payment or for commission, remuneration or other valuable consideration, shall except in relation to any sale, supply or distribution of surplus, unserviceable or old stores or materials or waste products or obsolete or discarded machinery or parts or accessories thereof, be deemed to be a dealer for the purposes of this Act [Section 2(b)].

4. Sales tax law

Sales tax law means any law for the time being in force in any State or part thereof, which provides for the levy of taxes on the sale or purchase of goods generally or *on any specified goods expressly mentioned in that behalf* and includes Value Added Tax (VAT) law, and

“general sales tax law” means the law for the time being in force in any State or part thereof which provides for the levy of tax on the sale or purchase of goods generally and includes VAT law [Section 2(i)].

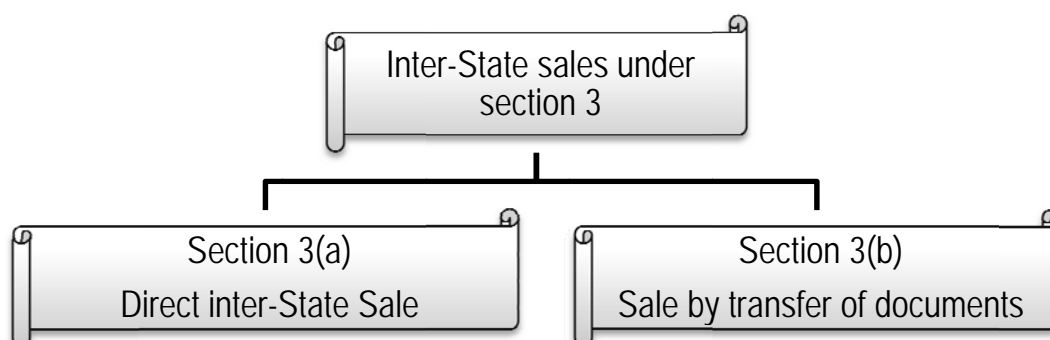
5. Business

Business- includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture, whether or not such trade, commerce, manufacture, adventure or concern is carried on with a motive to make profit and whether or not any gain or profit accrues from such trade, commerce, manufacture, adventure, or concern. It also includes any transaction in connection with, or incidental or ancillary to such trade, commerce, manufacture, adventure or concern [Section 2(aa)].

6. Place of Business

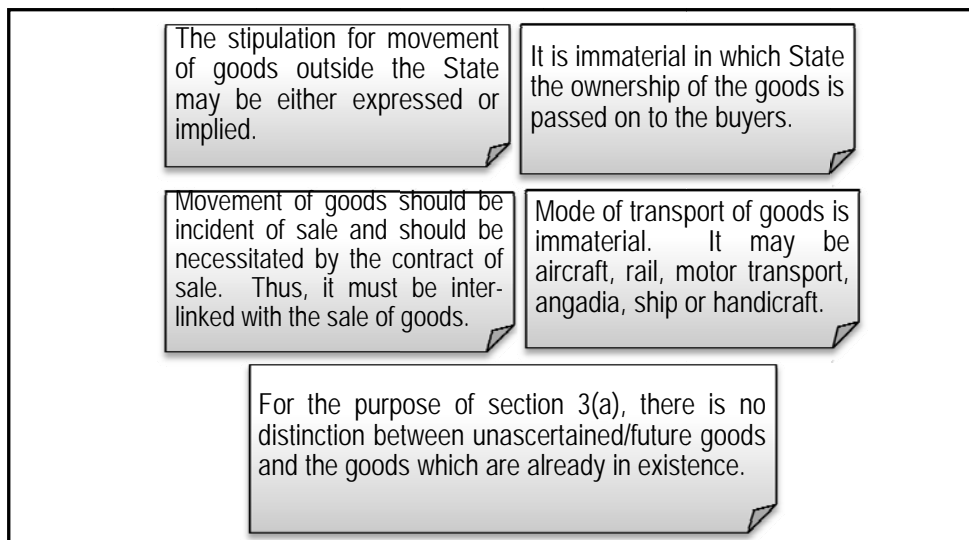
Place of business: includes (i) in any case when a dealer carries on business through an agent (by whatever name called), the place of business of such agent; (ii) a warehouse, godown or other place where a dealer stores his goods; and (iii) a place where a dealer keeps his books of account [Section 2(dd)].

4.8 Inter-State Sale



A.-Section 3(a)-Where sale occasions movement of goods from one State to another

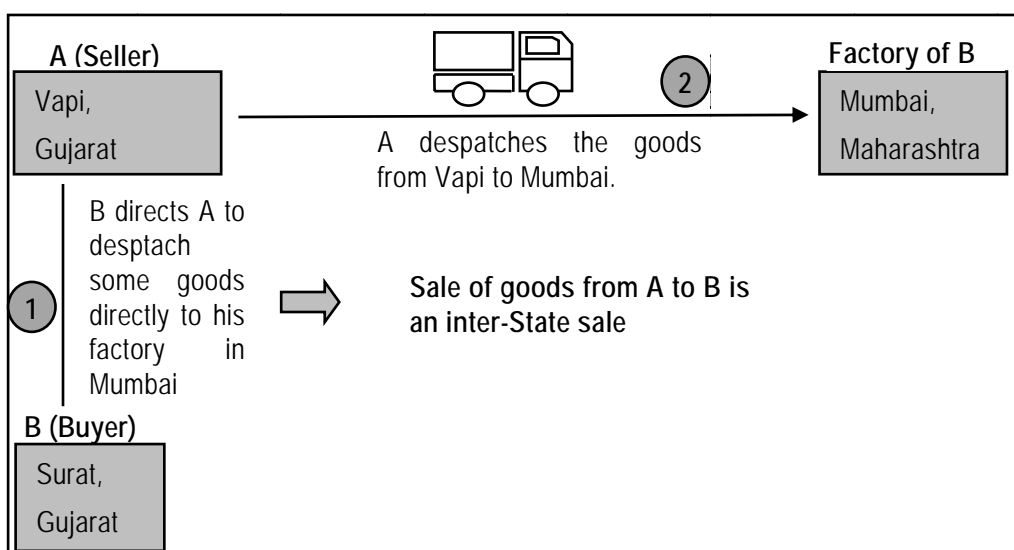
As per section 3(a), inter-State sale takes place if sale occasions the movement of goods from one State to another. In this regard, following points merit consideration:-



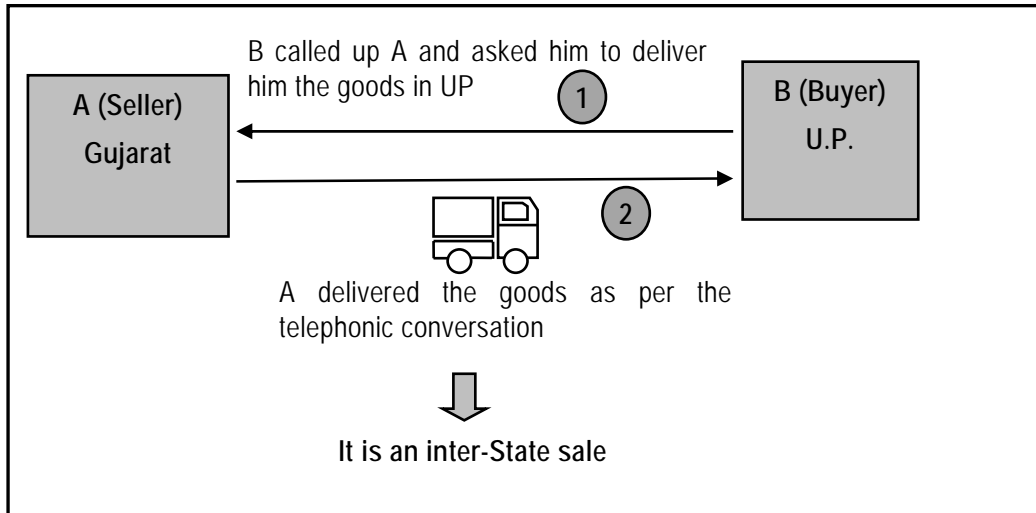
Note: Where the movement of goods commences and terminates in the same State it shall not be deemed to be a movement of goods from one State to another by reason merely of the fact that in the course of such movement, the goods pass through the territory of any other State [Explanation 2 to section 3].

Examples to illustrate the concept of inter-State sale under section 3(a)

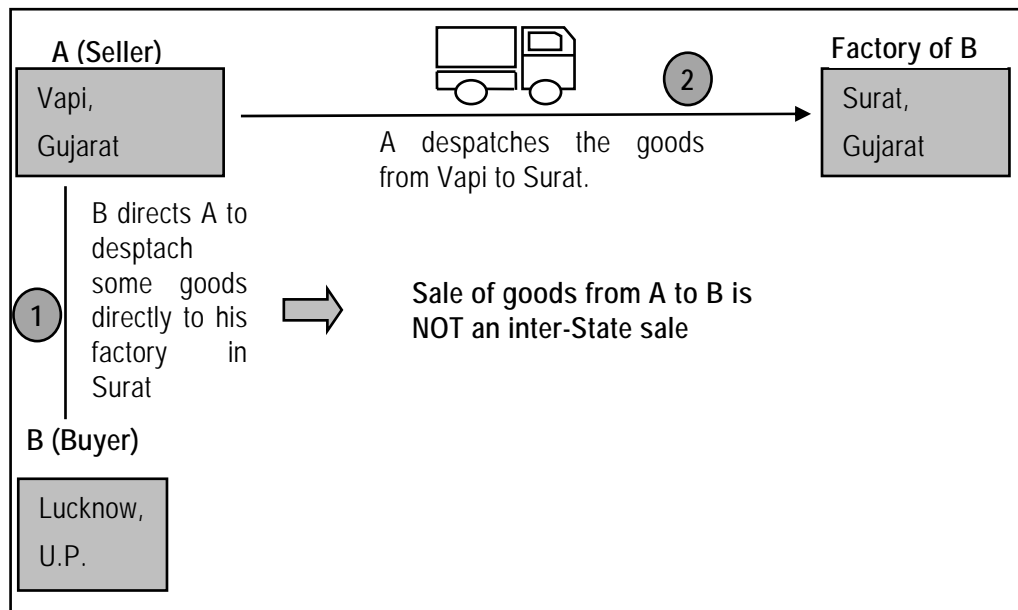
Example 1: Even if the buyer and seller are in the same State, it is an inter-State sale if the sale occasions the movement of goods from one State to another.



Example 2 : Movement of goods on the basis of telephonic conversation is sufficient to be held as inter-State sale



Example 3: Even if the buyer is located outside the State, sale is not an inter-State sale if the goods do not move outside the State



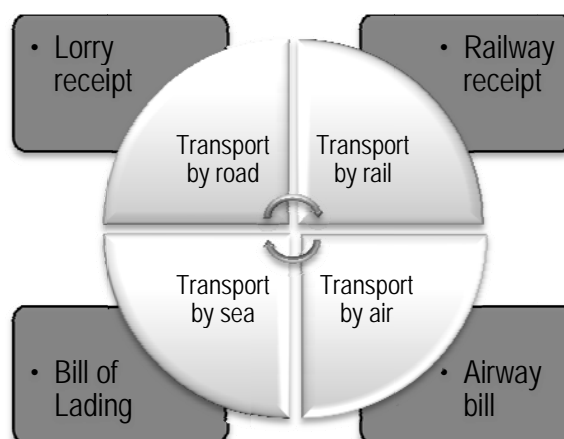
B.-Section 3(b)-Where sale or purchase is effected by a transfer of documents of title to the goods during their movement from one State to another

As per section 3(b), a sale or purchase shall be deemed to take place in the course of inter-State trade or commerce if the sale or purchase is effected by a transfer of documents of title to the goods *during their movement from one State to another*.*

**It is important to note here that unlike section 3(a), the movement of goods from one State to another need not necessarily be occasioned by sale under this clause.*

ANALYSIS

- (a) **Meaning of 'Documents of title to the goods':** Documents of title to the goods is generally a lorry receipt in case of transport by road, railway receipt in case of transport by rail, bill of lading in case of transport by sea and airway bill in case of transport by air.



Document of title to the goods substantiates that the person holding the document has the title to the goods mentioned in the document. Transfer of title to the goods means transfer of right of possession of such goods or control over such goods. Thus, a person in whose name the document of title to the goods is endorsed would be entitled to the delivery of the goods.

Document of title to the goods as per the Sales of Goods Act, 1930:

As per section 2(4), document of title to the goods includes a bill of lading, dock warrant, warehouse keeper's certificate, wharfingers' certificate, railway receipt, multimodal transport document, warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented.

- (b) **Transfer must be during the movement of goods:** A sale would be covered under clause (b) of section 3 [and termed as inter-State sale] if sale/purchase is effected by transfer of documents of title to the goods during the movement of such goods from one place to another.

Commencement and termination of movement of goods: Where goods are delivered to a carrier or other bailee for transmission, the movement of the goods shall be deemed

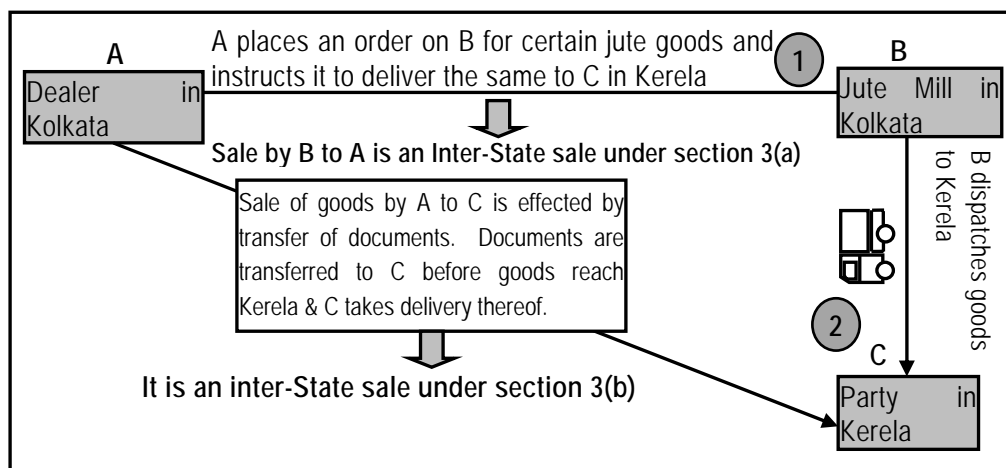
to commence at the time of such delivery and terminate at the time when delivery is taken from such carrier or bailee [Explanation 1 to section 3].

Thus, any sale by transfer of documents of title to the goods after the goods are delivered to a carrier, but before *physical delivery of such goods is taken* at the final destination would be termed as inter-State sale.

Example 1: Ram, a dealer in Haryana, got an order for delivery of goods in U.P. He sent the goods from Haryana to U.P. by rail. In this case, movement of goods commenced at the time when the goods were handed over to the railway booking office at Haryana for transportation to U.P.

The movement of goods would be deemed to continue even if the goods reach U.P. and were lying in the possession of railways. Movement would be deemed to be terminated only at the time when delivery was actually taken at U.P. on submission of railway receipt.

Example 2:



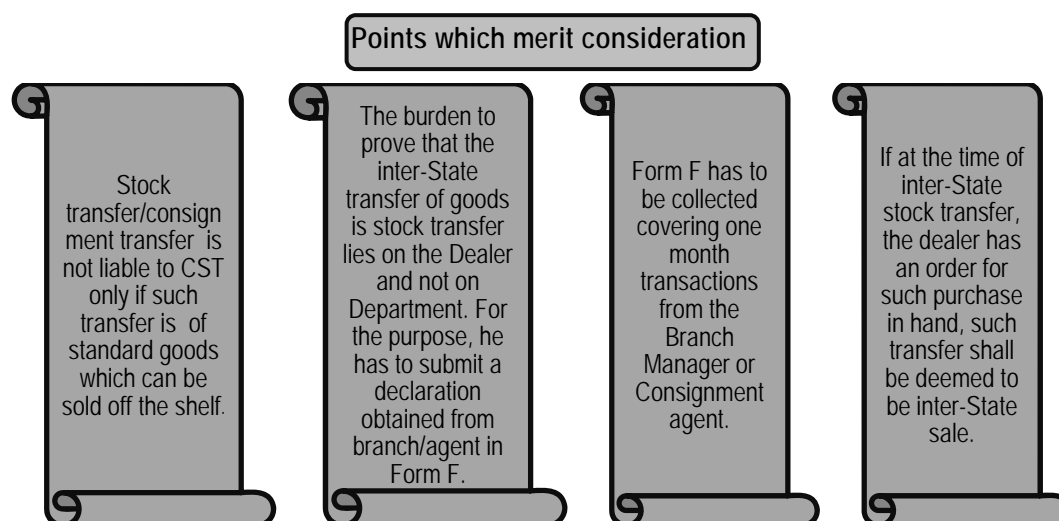
4.9 Inter-State stock transfer/inter-State consignment transfer [Section 6A]

Sometimes, a dealer (principal) sends the goods to his consignment agent in another State so that the goods are sold by the agent in that State on his behalf. Similarly, a dealer may send the goods to his own branch/depot in another State from where such goods can be sold. Section 6A applies to a situation where the goods are sent by a dealer, outside the State to his other place of business or his agent/principal in other State. In other words, this section covers the inter-State consignment transfer/ inter-State branch transfer.

In the aforesaid cases, although goods have been transferred from one State to another, generally, the property in goods does not pass from principal to the agent. Thus, there is no

sale and consequently, no CST is payable provided there was no pre-existing agreement for the sale of the goods so transferred.

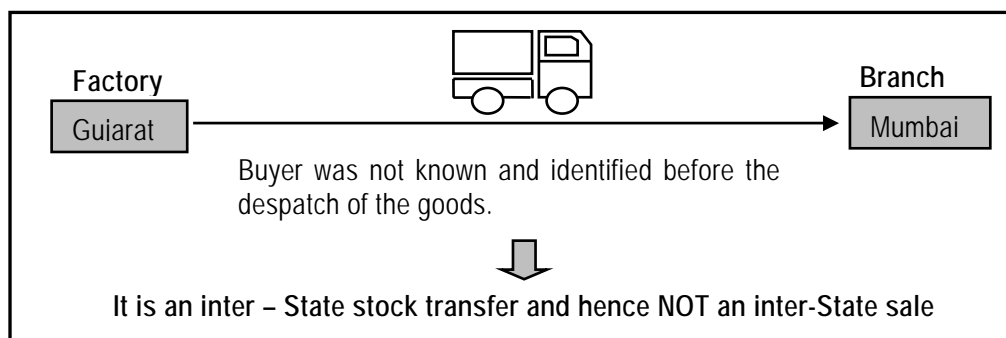
The burden of proving that the movement of those goods was occasioned NOT by reason of sale shall be on the dealer transferring the goods to his branch/agent/principal. For this purpose, he may furnish Form F to the assessing authority, within 3 months from the end of the period to which such form relates, obtained from the principal officer of the other place of business, or his agent or principal.



Examples illustrating the concept of inter-State stock transfer/branch transfer:

Example 1

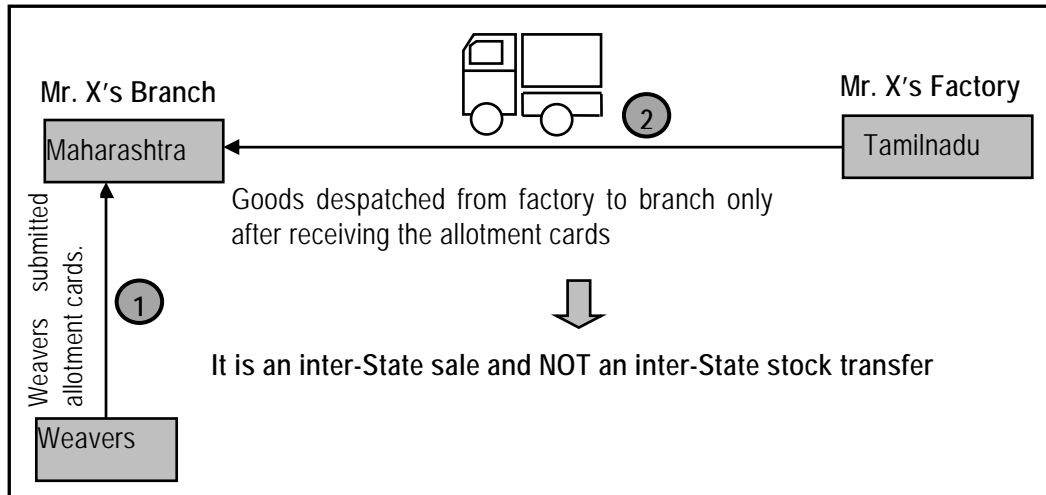
Mr. A, a registered dealer, transferred goods from his factory in Gujarat to Mumbai branch so that the goods can be sold from there.



Example 2

Maharashtra Government formulated a policy under which it issued 'allotment cards' to the weavers. The weavers, on production of such allotment cards, could get the 'viscose yarn' at concessional rates. In the below mentioned example, weavers submitted the allotment cards to

Mr. X, a dealer of viscose yarn in Maharashtra. On receiving these cards in branch from the weavers, Mr. X got the goods despatched from his factory in Tamilnadu to his branch in Maharashtra.



4.10 Sale outside the State [Section 4]

States are empowered to impose tax only on intra-State sales and not on inter-State sales of goods by virtue of Entry 54 of the State List.

Further, Article 286(1)(a) of the Constitution of India stipulates that State cannot impose a tax on the sale or purchase of goods where such sale or purchase takes place outside the State and the power to formulate principles for determining as to when a sale or purchase of goods shall be deemed to have taken place outside the State has been conferred on the Parliament by clause (2) of Article 286.

Combined reading of article 286 and Entry 54 makes it apparent that a State can levy sales tax only on intra-State sales of goods provided such sales takes place inside such State and outside all other States.

The principles as to when a sale is deemed to take place inside a State and when it is deemed to take place outside a State have been formulated under section 4 of the Central Sales Tax Act. It reads as follows:-

- (1) Subject to the provisions contained in section 3, when a sale or purchase of goods is determined in accordance with sub-section (2) to take place inside a State, such sale or purchase shall be deemed to have taken place outside all other States.
- (2) A sale or purchase of goods shall be deemed to take place inside a State if the goods are within the State-
 - (a) in the case of specific or ascertained goods, at the time the contract of sale is made; and

- (b) in the case of unascertained or future goods, at the time of their appropriation to the contract of sale by the seller or by the buyer, whether assent of the other party is prior or subsequent to such appropriation.

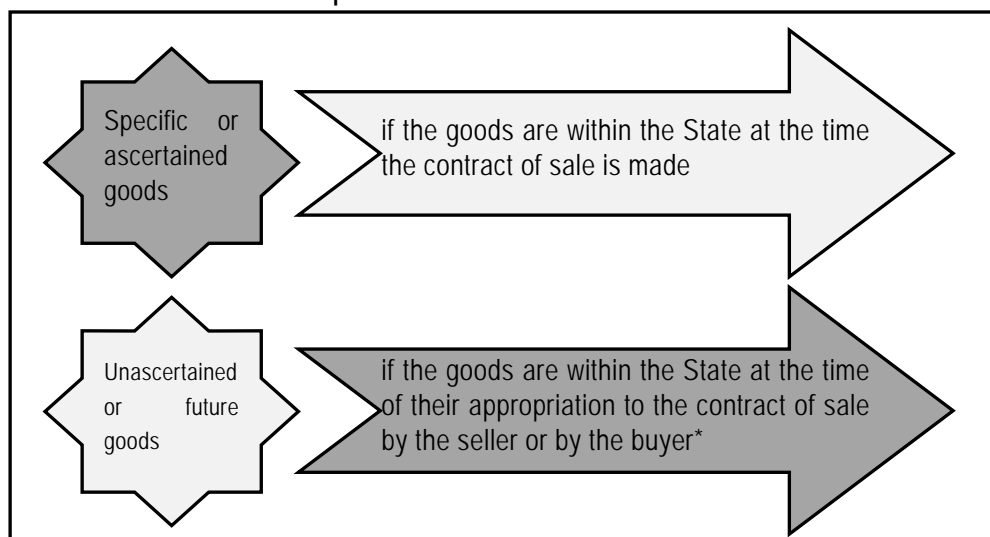
Explanation- Where there is a single contract of sale or purchase of goods situated at more places than one, the provisions of this sub-section shall apply as if there were separate contracts in respect of the goods at each of such places.

ANALYSIS: Before going through the provisions of section 4, one must be conversant with the concept of specific goods, ascertained goods and unascertained goods as explained hereunder:-

- ♣ **Specific goods:** means goods identified and agreed upon **at the time a contract of sale is made** [Section 2(14) of the Sales of Goods Act, 1930]. Thus, these are the goods which are in existence and which are identified by the parties at the time of contract of sale.
- ♣ **Unascertained goods:** means the goods defined only by description and **not identified and agreed upon** at the time of contract. Unascertained goods may be **existing goods or future goods**.
- ♣ **Ascertained goods:** Unascertained goods become "ascertained" when after the contract of sale has been made, the goods are identified in accordance with the agreement.

Section 4(1) does not actually define what is a 'Sale outside a State', but instead it describes what is a 'Sale inside a State' and that such a sale shall be outside all the other States.

- (a) **When is a sale/purchase deemed to take place inside a State?:** A sale or purchase of goods shall be **deemed to take place inside a State:-**

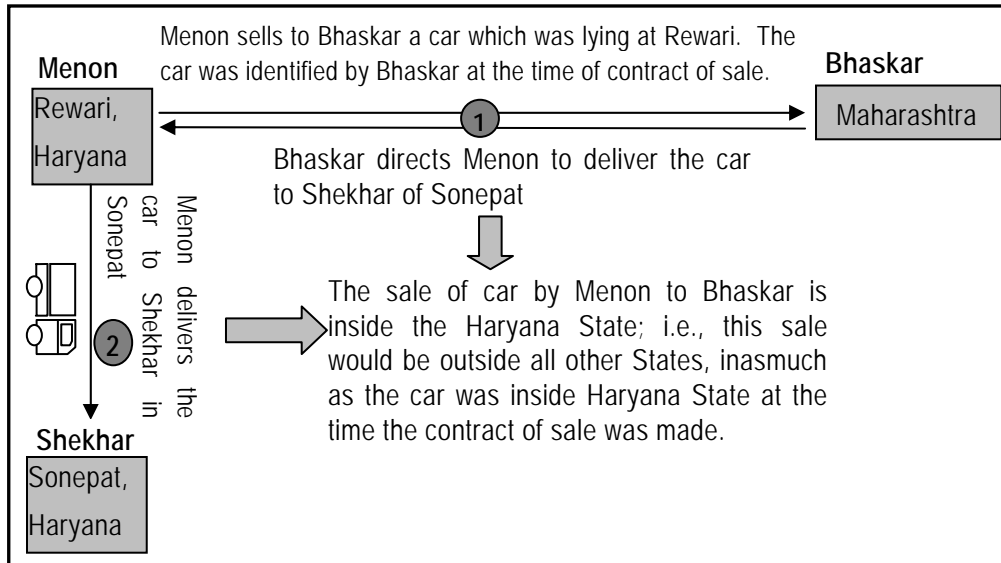


**Note: It is immaterial whether the other party to the contract gives his assent to the appropriation prior or subsequent to such appropriation.*

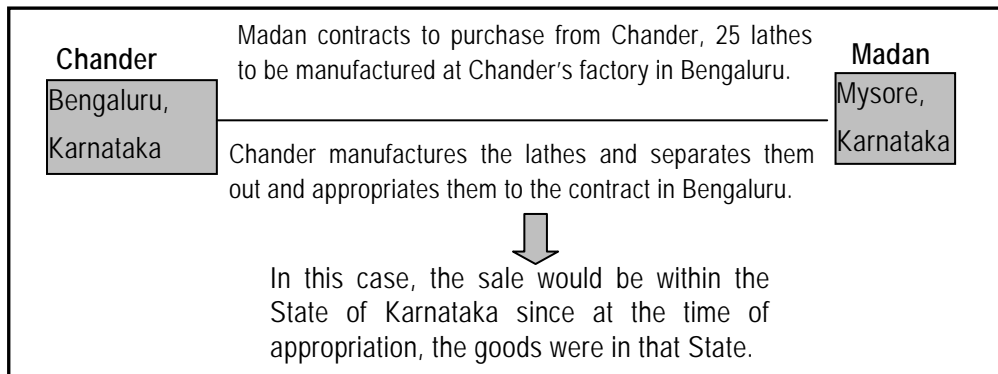
(b) **When is a sale/purchase deemed to take place outside a State?:** When a sale or purchase of goods has taken place inside a State in accordance with aforesaid provisions, such sale or purchase shall be deemed to have taken place **outside all other States**.

Illustrations explaining the concept of sale inside a State and sale outside a State

Example 1: Sale of specific goods



Example 2: Sale of unascertained goods



(c) **Single contract of sale of goods situated at more than one places**

In the case of both the above groups of goods (specific and unascertained), it may so happen that there is a single contract of sale or purchase of goods situated at more than one places. In such a case it shall be deemed that there are separate contracts in respect of the goods at each of such place.

(d) **Section 4 is subject to the provisions of section 3**

Section 4 is subject to the provisions of section 3. It implies that the provisions of section 4 would apply only when sales of goods is not an 'inter-State sale' under section 3. In case of

intra-State sales, sales tax shall be levied by the State inside which such sales is deemed to have taken place.

4.11 Sale in course of import/export [Section 5]

Article 286(1)(b) of the Constitution of India stipulates that State cannot impose a tax on the sale or purchase of goods where such sale or purchase takes in the course of import/export. Further, clause (2) of Article 286 confers the power on the Parliament to formulate principles for determining when a sale or purchase of goods shall be deemed to have taken place in the course of import/export.

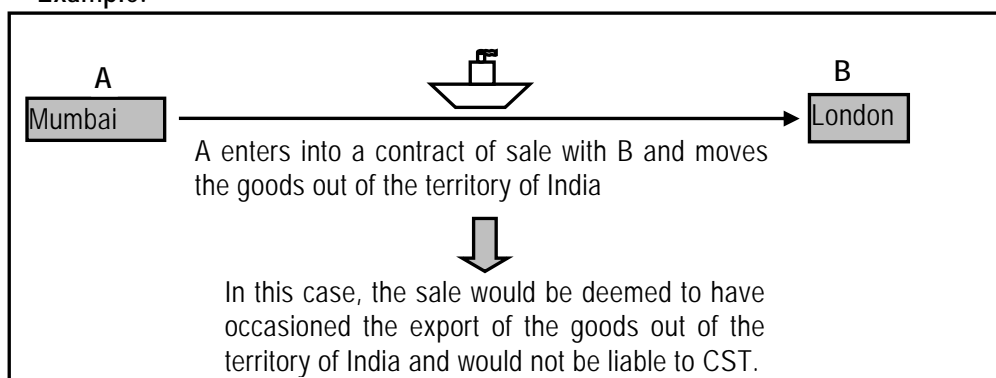
In exercise of the powers conferred by the Constitution, section 5 was introduced. Section 5 stipulates as to when a sale or purchase is deemed to take place in the course of import/export. Central sales tax is not leviable on sale in course of export/import. The provisions of section 5 have been discussed hereunder:-

Sale in the course of export

A sale or purchase of goods shall be deemed to take place in course of export of goods out of the territory of India only if:-

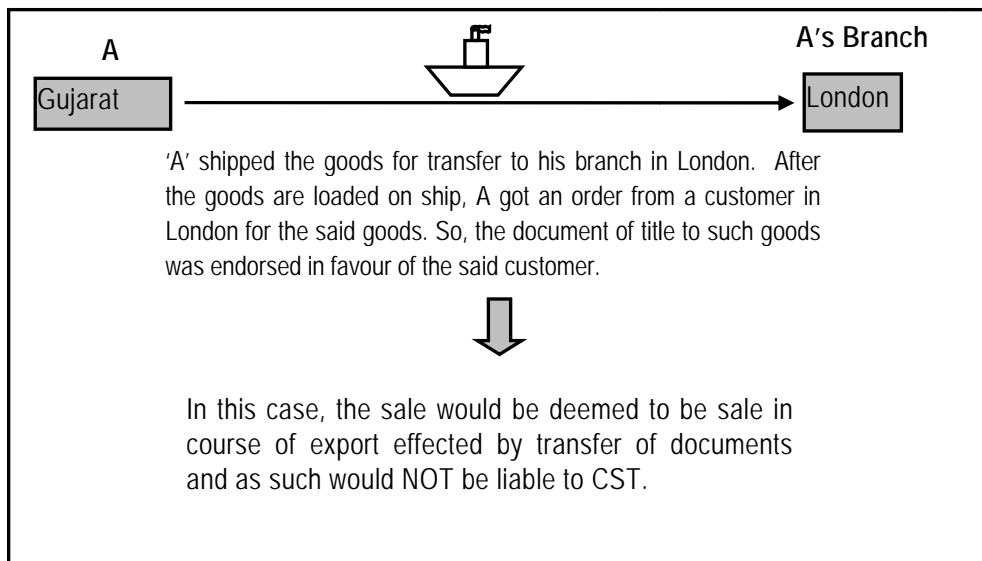
- (i) sale or purchase occasions such export, or
 - (ii) sale or purchase is effected by a transfer of documents of title to the goods after the goods have crossed the customs frontiers of India, or
 - (iii) it is penultimate sales.
- (a) **Sale/purchase occasioning the export:** In such a case:-
- (i) there shall be a sale of goods;
 - (ii) such sale shall occasion export, involving transshipment of goods from one country to the other and shall be between two parties of two countries and
 - (iii) the final result of transshipment shall be that the goods have come to rest in the other country.

Example:



- (b) **Sale or purchase effected by a transfer of documents of title to the goods:** In such a case, sale is effected by a transfer of documents of title to the goods **AFTER** the goods have crossed the customs-frontiers of India. Such transfer of documents of title to the goods can take place immediately on loading of goods in a conveyance after obtaining clearance from the customs authorities for export.

Example:



Points which merit consideration regarding sale occasioning export of goods or sale effected by transfer of documents of title to the goods after goods cross the customs frontier



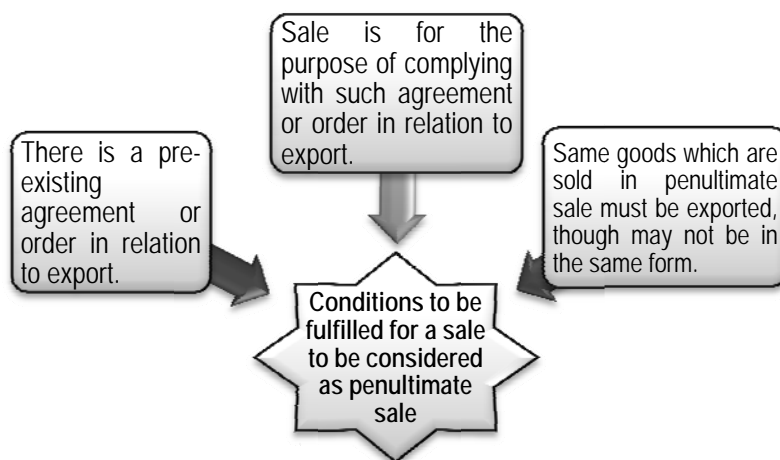
- (c) **Penultimate sales for export:** Penultimate sale is the sale preceding the sale occasioning the export. Such sale would also be deemed to be the sale in course of exports and would not be liable to central sales tax.

However, the penultimate sale or purchase is considered to be a sale or purchase in the course of export only if the dealer selling the goods furnishes a declaration in Form H, duly filled in and signed by the exporter to whom the goods are sold, to the prescribed authority in the prescribed form and manner.

Conditions to be fulfilled for a sale to be considered as penultimate sale:-

A sale is considered as penultimate sale if all the following conditions are fulfilled:-

- (i) There is a pre-existing **agreement or order in relation to export** [agreement with a foreign buyer and not an agreement or order with a local party containing the covenant to export].
- (ii) Penultimate sale must be, **after the agreement** with the foreign buyer, for the purpose of complying with such agreement or order in relation to export.
- (iii) Same goods which are sold in penultimate sale must be exported, though may not be in the same form.



Example: ABC Ltd. received export order for edible prawns. It purchased prawns from a local dealer and cleaned them. A small inedible portion was removed and the edible portion was exported. In the given case, purchase of prawns is a penultimate sale for exports.

- (d) **Purchase of ATF by any designated Indian carrier for the purposes of its international flight deemed to take place in course of export**

If any designated Indian carrier purchases Aviation Turbine Fuel for the purposes of its international flight, such purchase shall be deemed to take place in the course of the

export of goods out of the territory of India.

In this regard, following points merit consideration:-

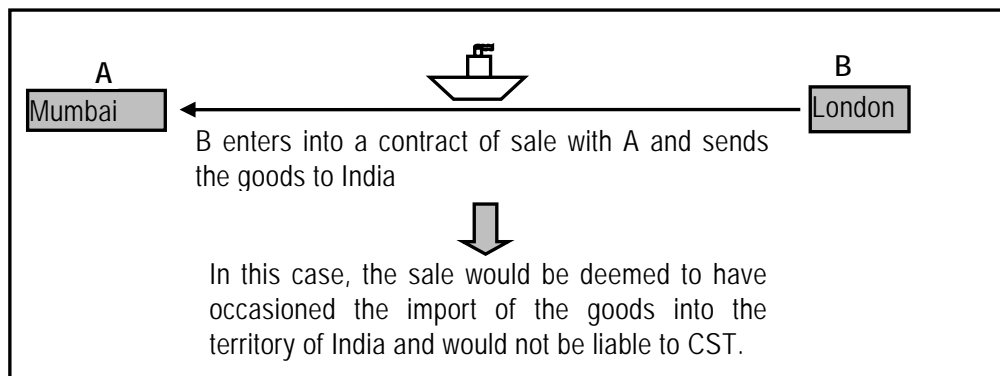
- ✓ CST and sales tax within the State will not be applicable on such purchase as it is not an inter-State sales, but a purchase in the course of the export.
- ✓ Exemption is only available to Indian carriers notified by the Central Government in this behalf. Some of the designated Indian carriers so specified are Air India, Indian Airlines, Jet Airways and Spicejet.
- ✓ Exemption is available only in case of international flights and not the domestic flights.

Sale in the course of import

A sale or purchase of goods shall be deemed to take place in course of import of goods into the territory of India only if:-

- (i) sale or purchase occasions such import, or
- (ii) sale or purchase is effected by a transfer of documents of title to the goods before the goods have crossed the customs frontiers of India,

(a) Sale occasioning the import: Below mentioned example elucidates the concept of sales occasioning the import:



(b) Sale or purchase effected by a transfer of documents of title to the goods: In such a case, sale is effected by a transfer of documents of title to the goods **BEFORE** the goods have crossed the customs-frontiers of India. Such transfer of documents of title to the goods can take place at any time before clearance of goods from customs. Import starts when the goods cross the customs barrier in a foreign country and ends when they cross customs barrier in the importing country.

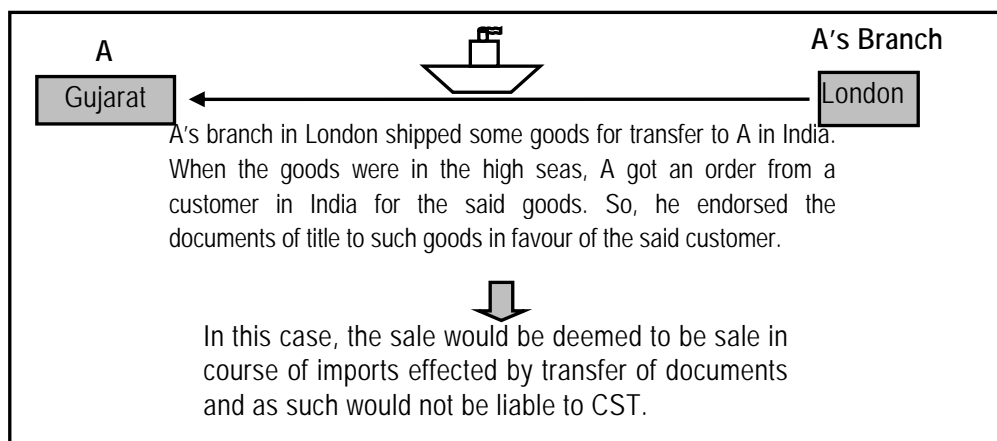
Further, if the documents are transferred when goods are in customs bonded warehouse, it will be treated as transfer of documents before the goods cross the customs barrier. However, on the other hand, if the imported goods are cleared from customs and then sold to a buyer in

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India, such sale would not be termed as sale in course of import. Such sale shall be inter-State sale or intra-State sale, as the case may be.

For instance, if Bill of Lading is endorsed in favour of buyer before the goods have crossed the limit of customs port or if the letter of delivery issued by bank is endorsed in favour of buyer before taking the delivery from customs, it is sale in course of imports.

Example:



Meaning of crossing the customs frontiers of India: Crossing the customs frontiers of India means crossing the limits of the area of a customs station* in which imported goods/export goods are ordinarily kept before clearance by customs authorities.

**Customs station means any customs port [in case of a vessel], customs airport [in case of an aircraft] or land customs station [in case of a vehicle].*

4.12 Rates of tax on sales in the course of inter-State trade or commerce

As per section 8(1), the liability to pay CST is on the dealer who sells the goods in the course of inter-State trade or commerce. For computing CST payable, the applicable rates would be determined as per the provisions of sub-sections (1) to (4) of section 8, in the following manner:

CASE – I : CONCESSIONAL RATE OF CST IS APPLICABLE:

The concessional rate of CST is:-

- (i) 2% of the turnover of the dealer
 - or
 - (ii) Rate applicable to the sale or purchase of such goods inside the appropriate state* under the sales tax law of that State
- whichever is lower.

***Appropriate State means-**

- (i) in relation to a dealer who has one or more places of business situated in the same State: that State;
- (ii) in relation to a dealer who has places of business situated in different States: every such State with respect to the place or places of business situated within its territory [Section 2(a)].

Conditions to be fulfilled for concessional rate of CST: A dealer is liable to pay CST at the concessional rate provided the following conditions are satisfied:-

- (I) **Sale is of eligible goods:** Goods described in sub-section (3)* are the goods eligible for concessional rate of CST (refer Note below).
- (II) **Sale is made to a registered dealer:** The dealer can pay CST on inter-State sale of such eligible goods at the concessional rate provided the sale has been made to a registered dealer.
- (III) **Form C to be furnished by the purchasing dealer:** The selling dealer is required to obtain a declaration in Form C from the purchasing dealer and furnish it to the prescribed authority, in order to secure the concession in rate of tax.

***Note:** Following goods as specified in the certificate of registration of the **registered purchasing dealer**, are eligible for concessional rate of CST:-

- (a) goods of the class/classes intended:-
 - (i) for resale by him, or
 - (ii) for use by him in manufacture or processing of goods for sale, or
 - (iii) for use in the telecommunications network, or
 - (iv) for use in mining, or
 - (v) for use in the generation or distribution of electricity or any other form of power.
- (b) containers or other materials intended for being used for the packing of goods for sale.

Further, containers or other materials used for the packing of any goods referred to in clause (a) or (b) above are also so eligible [Section 8(3)].

CASE – II : CONCESSIONAL RATE OF CST IS NOT APPLICABLE:

In case any of the aforesaid three conditions are not fulfilled, the rate of CST would be the rate applicable to the sale or purchase of such goods inside the appropriate State under the sales tax law of that State.

Rates of CST at a glance:-

| In case rate of sales tax within the State is | CST rate in case of sale to registered dealers is | CST rate in case of sale to unregistered dealers is |
|---|---|---|
| less than 3% | applicable rate of sales tax within the State | applicable rate of sales tax within the State |
| 3% or more | 2% | |

Illustration: Ram of Gujarat, a registered dealer, purchases goods specified in section 8(3) from Shyam of Maharashtra and furnishes Form C to Shyam with regard to such purchase of goods. Calculate the CST rate applicable assuming that the rate of sales tax within Maharashtra is:-

- (i) Nil
- (ii) 1%
- (iii) 2%
- (iv) 3%
- (v) 4%
- (vi) 5%
- (vii) 8%
- (viii) 10%
- (ix) 13.5%
- (x) 20%

Will your answer be different in case Ram is not a registered dealer?

Solution:

| Sales tax rate for sale within the State | CST rate in case Ram is a registered dealer and furnishes Form C | CST rate in case Ram is an unregistered dealer |
|--|--|--|
| Nil | Nil | Nil |
| 1% | 1% | 1% |
| 2% | 2% | 2% |
| 3% | 2% | 3% |
| 4% | 2% | 4% |
| 5% | 2% | 5% |
| 8% | 2% | 8% |
| 10% | 2% | 10% |
| 12.5% | 2% | 12.5% |
| 20% | 2% | 20% |

4.13 Determination of turnover for central sales tax [Section 8A]

Turnover means the aggregate of the sale prices received and receivable by any dealer liable to CST under this Act in respect of sales of any goods in the course of inter-State trade or commerce made during any prescribed period* and determined in accordance with the provisions of this Act and the rules made thereunder [Section 2(j)].

***Prescribed period** is the period in respect of which a dealer is liable to submit returns under the general sales tax law of the appropriate State. However, if a dealer is not liable to submit returns under the general sales tax law of the appropriate State, such period shall be a quarter ending on 30th June, 30th September, 31st December and 31st March, as the case may be, in a financial year.

Example: Mr. A is a dealer registered in Delhi. He is required to file the return quarterly under the Delhi VAT Act, 2004. Thus, for the purposes of the Central Sales Tax Act, the turnover would be the aggregate of the sale prices received and receivable by him in respect of sales of any goods in the course of inter-State trade or commerce made during three months.

DEDUCTIONS TO BE MADE WHILE COMPUTING THE TURNOVER

While determining the turnover of a dealer for the purposes of computing CST payable, following deductions shall be made from the aggregate of the sale prices:-

- (i) Central sales tax payable
- (ii) Sale price of all goods returned to the dealer by the purchasers of such goods within a period of six months from the date of delivery of the goods.
- (iii) Such other deductions as the Central Government may, having regard to the prevalent market conditions, facility of trade and interests of consumers, prescribe [Section 8A].

ANALYSIS: Following deductions are allowed to be made from the aggregate of the sale prices while computing the turnover:-

- (i) **Central sales tax payable:** The aggregate of sales price is taken inclusive of central sales tax, whether it is shown separately in the invoice or not.

Consequently, the turnover is arrived at by deducting the CST from the aggregate of sales price. CST is calculated as follows:-

$$\text{CST} = \text{Aggregate of sales price} \times \frac{\text{Rate of tax}}{100 + \text{Rate of tax}}$$

Alternatively, turnover may be calculated by making back calculation in the following manner:-

$$\text{Turnover} = \text{Aggregate of sales price} \times \frac{100}{100 + \text{Rate of tax}}$$

Explanation- Where the turnover of a dealer is taxable at different rates, the aforesaid formulas shall be applied separately in respect of each part of the turnover liable to a different rate of tax.

- (ii) **Sale price of all goods returned by the purchasers:** Deduction of sale price of all goods returned is available from the aggregate of the sales prices provided:-
- (a) the goods are returned by the purchaser within a period of 6 months from the date of delivery of the goods, and
 - (b) satisfactory evidence of such return of goods and of refund or adjustment in accounts of the sale price thereof is produced before the competent authority.
- (iii) Such other deductions as the Central Government may, having regard to the prevalent market conditions, facility of trade and interests of consumers, prescribe.

Note: The period of six months for return of goods is not applicable in respect of rejected goods as it is a case of un-fructified sale.

MEANING OF SALE PRICE

Sale price means the amount payable to a dealer as consideration for the sale of any goods, less any sum allowed as cash discount according to the practice normally prevailing in the trade, but inclusive of any sum charged for anything done by the dealer in respect of the goods at the time of or before the delivery thereof other than the cost of freight or delivery or the cost of installation in cases where such cost is separately charged [Section 2(h)].

ANALYSIS:

- (A) **Definition of sale price:** As per section 2(h), sale price means the amount payable to a dealer as consideration for the sale of any goods subject to following inclusions and exclusions:-

Inclusions in the sale price:-Any sum charged for anything done by the dealer in respect of the goods at the time of or before the delivery thereof.

Exclusions from the sale price:-Following are to be excluded from the sale price:-

- (a) Any sum allowed as cash discount according to the practice normally prevailing in the trade.
- (b) **Cost of freight/delivery:** The cost of freight/ delivery or cost of installation is excluded where such cost is separately charged by the dealer.

Cost of freight or delivery is includible only if:-

- (a) it is NOT shown separately in an invoice or
- (b) Contract is for sale FOR destination and property in goods is transferred only at destination.

In case of sale of goods from depot, freight from factory to depot is includible in sale price even if shown separately in invoice.

(B) **Other Inclusions and Deductions from sale price:** In addition to the inclusions and exclusions (as discussed above) from the sale price specifically mentioned in the definition of sale price, few other inclusions and exclusions have been discussed below. The same have been arrived at on the basis of the legal decisions rendered in this regard.

1. **Dharmada** - Charity or dharmada collected by the dealer will form part of the sale price because so far as the purchaser is concerned, he has to pay the whole amount for purchasing the goods.
2. **Weighment dues** - If the services of weighing are in respect of the goods and incidental to their being sold, the dues charged are to be included in the sale proceeds.
3. **Insurance charges** - Insurance charges incurred by the assessee prior to the delivery of the goods form part of sale price.
4. **Packing charges** - The packing charges realised by the dealer is an integral part of the sale price and hence includible. Further, cost of packing material is also includible in sale price.
5. **Indemnity/Guarantee charges** - Indemnity / guarantee charges recovered from the same buyers to incur loss during transit at buyers' request are allowed as deduction from the sale price.
6. **Discount according to trade practice** - Any sum allowed as discount according to the practice normally prevailing in the trade will not form part of the "sale price".
7. **Excise duty** - Excise duty paid by a dealer in respect of the goods which he sells will not be liable to be deducted from his turnover.
8. **Government subsidies** - Where a product is 'controlled' and has to be sold at 'controlled price' subsidies are granted by the Government to manufacturers to compensate the cost of production which is usually higher than the controlled price. Such subsidy will not form part of sale price or turnover.
9. **Design Charges** - Design charges charged separately in respect of goods manufactured as per design and sold to buyer are includible.
10. **Deposits for returnable containers/bottles:** are not includible in the sale price.
11. **Free of cost material supplied by customer** - is not includible in sale price.

(C) **Sale price in case of works contract:** In the case of a transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract, the *sale price of such goods shall be determined in the prescribed manner** by making such deduction from the total consideration for the works contract as may be prescribed and such price shall be deemed to be the sale price for the purposes of this clause.

**Note: So far no rules have been framed by the Central Government.*

Collection of tax to be only by registered dealers [Section 9A]

No person who is not a registered dealer shall collect in respect of any sale made by him of goods in the course of inter-State trade or commerce any amount by way of tax under this Act, and no registered dealer shall make any such collection except in accordance with this Act and the rules made thereunder.

CST payable to be rounded off [Section 9B]

The amount of central sales tax, interest, penalty, fine or any other sum payable, and the amount of refund due, under the provisions of this Act shall be rounded off to the nearest rupee*.

However, this provision does not apply to CST collected by a dealer. It implies that when a dealer collects CST from the buyer, he may charge it in the invoice without rounding off, but when the same is credited to the Government, amount needs to be rounded off to the nearest rupee.

**Note: For this purpose, where such amount contains a part of a rupee consisting of paise, then, if such part is fifty paise or more, it shall be increased to one rupee and if such part is less than fifty paise, it shall be ignored.*

SOME ILLUSTRATIONS EXPLAINING THE COMPUTATION OF CST LIABILITY:

Illustration 1: Mr. D, a first stage dealer in packing machinery in the State of Gujarat furnishes the following data:

| | ₹ |
|--|-----------|
| Sale proceeds of inter-State sales during F.Y. 2013-14 (CST not shown separately) | 92,50,000 |
| <u>Above sales include:</u> | |
| Excise duty | 9,00,000 |
| Freight (of this ₹ 50,000 is not shown separately in invoices) | 1,50,000 |
| Insurance charges incurred prior to delivery of goods | 32,000 |
| Installation and commissioning charges shown separately | 15,000 |
| Design charges charged separately | 30,000 |

Determine the turnover and CST payable, assuming that all transactions were covered by valid 'C' Forms and sales tax rate within the State is 5%.

Solution:

Computation of Mr. D's turnover and central sales tax payable

| | ₹ | ₹ |
|---|----------|--------------|
| Sale proceeds of inter-state sales | | 92,50,000.00 |
| Less: Freight shown separately in the invoices | 1,00,000 | |
| Less: Installation and commissioning charges shown separately | 15,000 | |
| | | 1,15,000.00 |
| Turnover including CST (A) | | 91,35,000.00 |
| Less: CST payable $(91,35,000 \times 2/102)$ (B) | | 1,79,117.65 |
| Turnover excluding CST (A - B) | | 89,55,882.35 |
| Central sales tax payable (rounded off) | | 1,79,118 |

Notes –

- Excise duty forms part of the sale price and is not deductible.
- Freight not shown separately in the invoices and insurance charges incurred prior to delivery of goods are not deductible in calculating the turnover.
- Sale price includes design charges charged separately.
- The CST on transactions covered by valid 'C' forms is 2% or the sales-tax rate within the State, whichever is lower. Since, in this case, the State sales-tax rate is higher than 2%, the rate of CST is taken as 2%.

Illustration 2: Mr. X reported inter-State sales of ₹ 36,20,000. This includes the following:

- Excise duty ₹ 3,00,000; and
- Deposit for returnable containers and packages ₹ 5,00,000.

Central sales tax was not included separately in the sales invoice.

Compute tax liability under the CST Act, assuming the rate of CST at 2%.

Solution:

Computation of central sales tax liability of Mr. X

| | ₹ |
|---|--------------|
| Total sales of Mr. X | 36,20,000.00 |
| Less: Deposit received towards returnable containers and packages | 5,00,000.00 |
| Turnover (including central sales tax) | 31,20,000.00 |
| Less : Central sales tax thereon = $31,20,000 \times 2/102$ | 61,176.47 |
| Turnover (excluding central sales tax) | 30,58,823.53 |

The central sales tax liability is ₹ 61,176 [rounded off] (being 2% of ₹ 30,58,823.53)

Note – Excise duty is part of turnover and hence should not be excluded from turnover.

Illustration 3: Mr. A's total inter-State sales are ₹ 52,00,000 for the year ended 31.03.2014. Further, goods sold in March, 2014 have been returned by the customers to the value of ₹ 5,20,000 in May, 2014. He had not charged tax separately in the sale invoices. Assuming that the applicable rate of CST is 2%, compute his CST liability.

Solution:

| | ₹ |
|---|-----------|
| Total sales | 52,00,000 |
| Less : Sale price of goods returned to the dealer by the purchaser of such goods (within 6 months from the date of delivery of the goods) | 5,20,000 |
| Turnover in terms of the Central Sales Tax Act | 46,80,000 |

Mr. A has not charged the amount of sales tax separately in the sales invoices. Therefore, according to section 8A, the sales tax has to be worked out applying the following formula

$$\frac{\text{Rate of tax} \times \text{Aggregate of sale price}}{100 + \text{Rate of tax}}$$

$$\begin{aligned} \text{Central sales tax liability} &= \frac{2 \times 46,80,000}{100 + 2} \\ &= \frac{93,60,000}{102} \\ &= \text{₹ 91,765 (rounded off)} \end{aligned}$$

Illustration 4: From the following details, compute the central sales-tax payable by a dealer carrying on business in New Delhi :

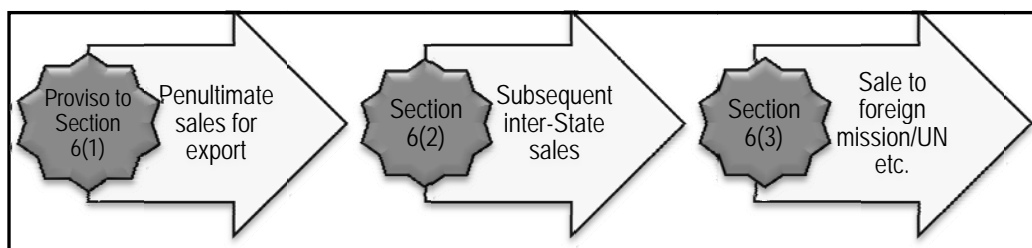
| | ₹ |
|--|-----------|
| Total inter-State sales (including CST) | 16,00,000 |
| (i) Trade commission for which credit notes have to be issued separately | 48,000 |
| (ii) Installation charges charged separately | 25,000 |
| (iii) Excise duty | 80,000 |
| (iv) Freight, insurance and transport charges recovered separately in the invoice | 60,000 |
| (v) Goods returned by dealers within six months of sale, but after the end of the financial year | 40,000 |
| Buyers have issued 'C' forms for all purchases. | |
| Sales tax rate within the State is 4%. | |

Solution:

| | | ₹ |
|--|--------|------------------|
| Sales as per bill (including CST) | | 16,00,000 |
| Less: Trade commission | 48,000 | |
| Installation charges charged separately | 25,000 | |
| Freight, transport charges | 60,000 | |
| Goods returned within 6 months | 40,000 | <u>1,73,000</u> |
| Turnover including CST | | <u>14,27,000</u> |
| Central sales tax @ 2% ($₹14,27,000 \times 2 / 102$) | | 27,980.39 |
| Turnover | | 13,99,019.61 |
| CST at 2% thereof (rounded off) | | 27,980 |

Note: The CST on transactions covered by valid 'C' forms is 2% or the sales-tax rate within the State, whichever is lower. Since, in this case, the State sales-tax rate is higher than 2%, the rate of CST is taken as 2%.

4.14 Exceptions to levy of central sales tax (CST)



I. No CST on penultimate sales for export [Proviso to section 6(1)]

A dealer shall not be liable to pay CST on the penultimate sales for export under section 5(3).

II. No CST on subsequent sales [Section 6(2)]

Where a sale of any goods in the course of inter-State trade or commerce has either occasioned the movement of such goods from one State to another or has been effected by a transfer of documents of title to such goods during their movement from one State to another, any subsequent sale during such movement effected by a transfer of documents of title to such goods to a registered dealer, if the goods are of description referred to in section 8(3), shall be exempt from tax under this Act.

However, no such subsequent sales shall be exempt from tax under this sub-section unless the dealer effecting the sale furnishes to the prescribed authority within three months after the end of the period to which the declaration/certificate relates or within such further time as that authority may, for sufficient cause, permit,--

- (a) a certificate duly filled and signed by the registered dealer from whom the goods were purchased containing the prescribed particulars in a prescribed form obtained from the prescribed authority (Form E-I/ Form E-II); and
- (b) if the subsequent sale is made to a registered dealer, a declaration referred to in sub-section (4) of section 8 (Form C).

Further, it shall not be necessary to furnish Form C as referred to in clause (b) above in respect of a subsequent sale of goods if,-

- (a) the sale or purchase of such goods is, under the sales tax law of the appropriate State, exempt from tax generally or is subject to tax generally at a rate which is lower than 3% (whether called a tax or fee or by any other name); and
- (b) the dealer effecting such subsequent sale proves to the satisfaction of the prescribed authority that such sale is of the nature referred to in this sub-section.

ANALYSIS: Since every sale, in the course of inter-State trade, is liable to tax, the levy can become a multiple levy if the goods change hands several times during their movement from one State to another. Thus, section 6(2) provides that subsequent inter-State sale of the goods shall not be liable to CST if the following conditions are satisfied:-

- (i) **First sale to be an inter-State sale:** First sale should be an inter-State sale i.e. either (a) sale of goods occasioning the movement of goods from one State to another or (b) sale effected by the transfer of documents of title to the goods. Moreover, the subsequent sale should be effected by the transfer of documents of title to the goods during the movement of such goods in course of inter-State sales.

Note: Subsequent sales is not liable to CST even if the first inter-State sale is exempt from CST.

- (ii) **Subsequent sales to a registered dealer:** Sale subsequent to an inter-State sale is exempt only if:-

- (a) purchaser is a registered dealer.
- (b) the goods are of description referred to in section 8(3).

- (iii) **Prescribed certificates to be furnished:** The dealer effecting the subsequent sale needs to furnish following certificates/declaration:-

- (a) **Form E-I/ Form E-II*:** obtained from the registered dealer from whom he has purchased the goods, and
- (b) **Form C:** Form C obtained from such dealer if subsequent sale is made to a registered dealer.

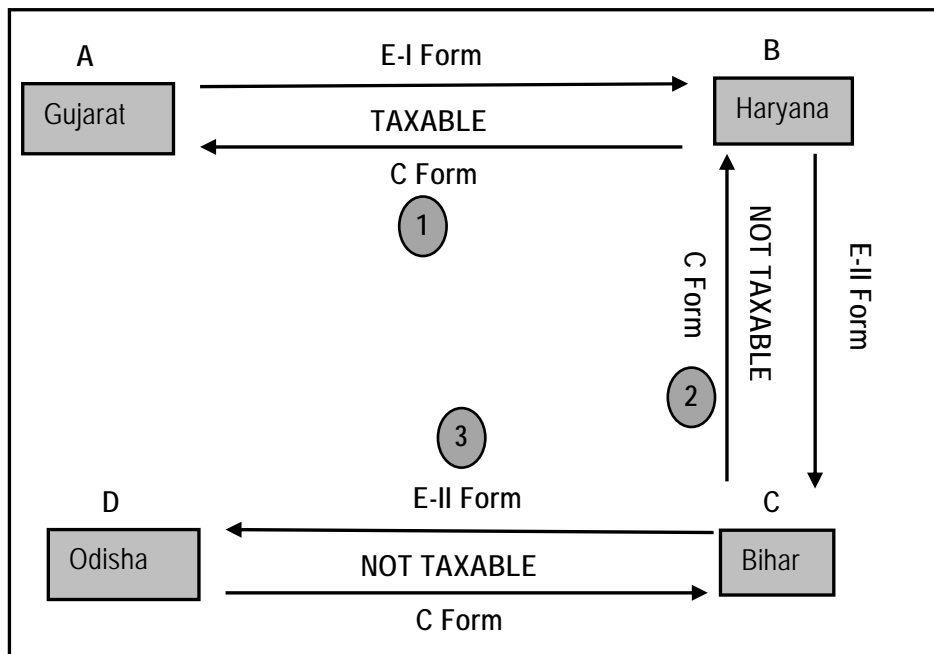
**Note: Form E-I is issued by the selling dealer who first moves the goods in case of inter-State sales. Form E-II is issued by the second or subsequent transferor of such goods.*

However, it shall not be necessary to furnish Form C in respect of a subsequent sale of goods if,-

- (a) the sale or purchase of such goods is, exempt from tax generally or is subject to tax lower than 3%, under the sales tax law of the appropriate State and
- (b) the dealer effecting such subsequent sale proves to the satisfaction of the prescribed authority that such sale is of the nature referred to in this sub-section.

The concept of subsequent sales and the certificates to be furnished can be better understood with the following example:-

Example: A of Gujarat sells the goods to B of Haryana. As per the contract, A was required to deliver the goods in Odisha. For this purpose, A dispatches the goods from Gujarat to Odisha. During the movement of goods, B sells the goods by transfer of documents of title to the goods, to C of Bihar who in turn sells them to D of Odisha during such movement. D ultimately takes the delivery of the goods. Here, all the four dealers are registered dealers.

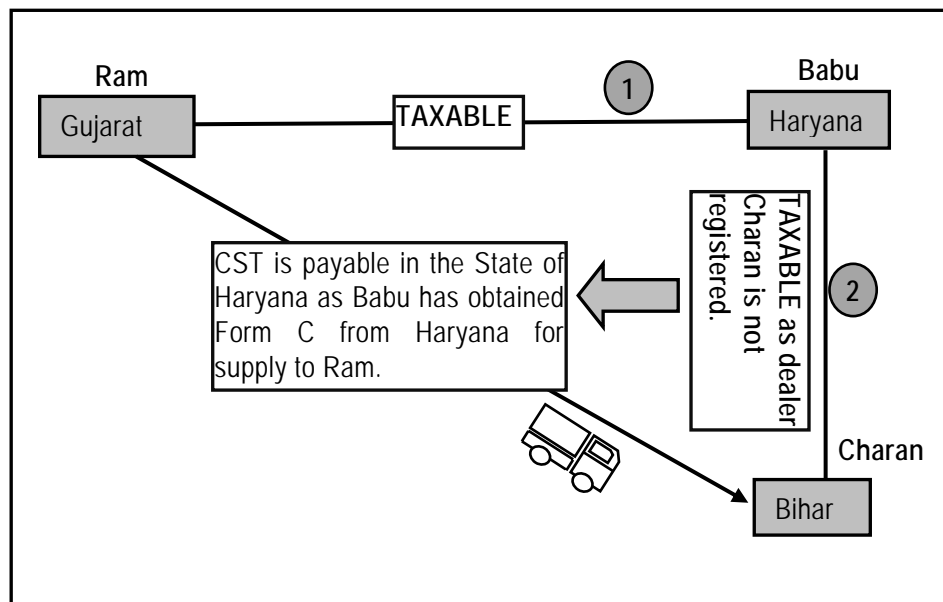


Levy of CST in case subsequent sales is taxable: If subsequent sale is made to an unregistered dealer or if necessary certificates/declaration are not furnished, the

subsequent sale would become taxable. Levy and collection of CST, in such cases, would be in the following States:-

- (a) **Where such subsequent sale has been effected by a registered dealer:** State in which the registered dealer obtains or could have obtained Form C from the sales tax authorities, in other words, the State in which he is registered.
- (b) **Where such subsequent sale has been effected by an unregistered dealer:** State from which such subsequent sale has been effected [Proviso to section 9(1)].

Example: Ram of Gujarat sells the goods to Babu of Haryana (a dealer registered in Haryana). As per the contract, Ram was required to deliver the goods in Bihar. For this purpose, Ram despatches the goods from Gujarat to Bihar and obtains Form C from Babu. During the movement of goods, Babu sells the goods by transfer of documents of title to the goods, to Charan of Bihar, an unregistered dealer who ultimately takes the delivery of the goods.



III. No CST on sale to foreign missions/UN etc. [Section 6(3)]

No CST is payable on sale of any goods made by a dealer, in the course of inter-State trade or commerce, to any official or personnel/consular or diplomatic agent of:-

- (i) any foreign diplomatic mission or consulate in India or
- (ii) the United Nations or any other similar international body

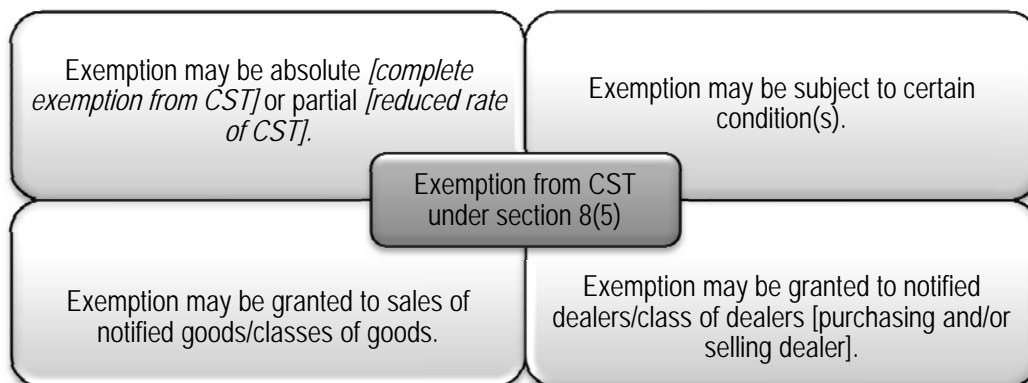
entitled to privileges under any convention or agreement to which India is a party or under any law for the time being in force if such official, personnel, consular or diplomatic agent, as the case may be, has purchased such goods for himself or for the purposes of such mission, consulate, United Nations or other body.

However, aforesaid exemption is available only if the dealer selling such goods furnishes to the prescribed authority Form J obtained from the official, personnel, consular or diplomatic agent.

4.15 Exemption from CST

Following exemptions may be granted from CST in case of sale to a registered dealer:-

- (I) **Exemption by notification granted by the State Government [Section 8(5)]:** State Government can grant exemption, by issuing a notification in the Official Gazette, in respect of the inter-State sales effected from the State subject to the fulfilment of the following conditions:-
 - (a) State government is satisfied that such exemption is necessary in the **public interest**.
 - (b) Sale must be made to a **registered dealer**.
 - (c) The selling dealer must furnish **Form C** as obtained from the registered purchasing dealer.



- (II) **Exemption from CST to a sale to unit/developer in SEZ [Section 8(6), 8(7) & 8(8)]:** A registered dealer in SEZ (unit in SEZ/developer of SEZ) can obtain goods from outside SEZ, for specified purposes, without payment of CST. Following conditions must be satisfied in order to claim the said exemption:-

1. Purposes for which unit/developer of SEZ may use the goods sold:

- (a) **Unit in SEZ:** for the purpose of setting up, operation, maintenance, manufacture, trading, production, processing, assembling, repairing, re-conditioning, re-engineering, packaging or for use as packing material or packing accessories in a unit located in any SEZ.

- (b) **Developer of SEZ:** for the purpose of development, operation and maintenance of SEZ by developer.
2. **Authorised unit/developer:** The unit in SEZ must be authorised to establish such unit or developer of SEZ must be authorized to develop, operate and maintain such SEZ, by the authority specified by the Central Government in this behalf.
 3. **Sale to registered dealer:** The goods must be sold to a unit/developer of SEZ who is a registered dealer.
 4. **Declaration to be furnished:** The purchasing dealer has to submit a declaration in Form I.
 5. **Goods specified in the registration certificate:** Goods should be of such class or classes of goods as specified in the Certificate of registration of the registered dealer.

Special Economic Zone (SEZ)

A Special Economic Zone (SEZ) is a geographically bound zone where the economic laws relating to export and import are more liberal as compared to other parts of the country. These are like a separate island within the territory of India. SEZs are projected as duty free area for the purpose of trade, operations, duty, and tariffs. SEZ is considered to be a place outside India for all tax purpose. Within SEZs, a unit may be set-up for the manufacture of goods and other activities including processing, assembling, trading, repairing, reconditioning, making of gold/ silver, platinum jewellery etc. As per law, SEZ units are deemed to be outside the customs territory of India. Goods and services coming into SEZs from the domestic tariff area or DTA are treated as exports from India and goods and services rendered from the SEZ to the DTA are treated as imports into India.

4.16 Goods of special importance/declared goods

Article 286(3) empowers the Parliament to declare some goods as 'goods of special importance' and to impose restrictions and conditions with regard to power of the States pertaining to levy, rates and other incidence of tax on such goods. Thus, Parliament can restrict the power of States to tax such declared goods.

State Government cannot levy sales tax within the State on these goods exceeding 5%. If declared goods are sold inter-State, tax paid within the State is reimbursed to seller provided the goods are sold inter-State in the same form.

A. Declared goods/Goods of special importance

As per section 2(c) of the Central Sales Tax Act, 1956, "**declared goods**" means goods declared under section 14 to be of special importance in inter-State trade or commerce. The following is an illustrative list of goods declared under section 14 to be of special importance in inter-state trade and commerce and thus constituting "**declared goods**":

- (i) Cereals

- (ii) Coal, including coke in all its forms, but excluding charcoal
- (iii) Cotton, (indigenous or imported) in its unmanufactured state, whether ginned or unginned, baled, pressed or otherwise, but not including cotton waste
- (iv) Cotton fabrics
- (v) Cotton yarn, but not including cotton yarn waste
- (vi) Crude oil
- (vii) Hides and skins, whether in a raw or dressed state
- (viii) Iron and steel
- (ix) Jute
- (x) Oilseeds
- (xi) Pulses
- (xii) Man-made fabrics.
- (xiii) Sugar.
- (xiv) Liquefied petroleum gas for domestic use

B. Restrictions imposed on the tax imposed on the declared goods

Section 15 lists the restrictions which are imposed on the sale of the declared goods. These restrictions are as follows:-

(i) Sales tax within the State not to exceed 5%

The tax payable under the sales tax law of a State in respect of any sale or purchase of such goods inside that State shall not exceed 5% of the sale or purchase price.

(ii) Sales tax imposed within the State if goods sold inter-State subsequently

If a tax is levied on sales or purchase of any declared goods inside a State and the same commodity is subsequently sold in the course of inter-State trade or commerce and is subjected to CST, the sales tax paid within the State realised previously in respect of the commodity is reimbursed. The said reimbursement is subjected to following conditions:-

- (a) the tax on the inter-State sale has been actually paid. Thus, it will not be possible for the dealer to claim back the tax paid by him in respect of the goods which subsequently became the subject-matter of an inter-State sale, unless he has actually paid the inter-State tax. Similarly, if the inter-State sale of the goods is exempt from tax, reimbursement of tax paid on intra-State sale is not available.
- (b) The inter-State sale of goods must be in the same form.

***Note:** The rates of taxes, wherever mentioned in the illustrations may not always be the actual rates prevalent during the period in question. They may be hypothetical rates assumed to explain the provisions of law with more clarity.*

UNIT – 5: VALUE ADDED TAX

Learning objectives

After reading Unit- 5 of this Chapter, you will be able to understand:

- ◆ the basic concepts of VAT - what is VAT, how does it operate, what are its different variants, what are the different methods of computation thereof and what are its merits and demerits
- ◆ the design of VAT in Indian context – CENVAT, State - Level VAT and proposed GST
- ◆ Constitutional provisions relating to levy of State - Level VAT
- ◆ what are the different VAT rates and coverage of goods
- ◆ the concept of input tax and output tax
- ◆ the concept of input tax credit
- ◆ how to compute the VAT liability
- ◆ the provisions relating to Composition Scheme for small dealers
- ◆ the position of VAT *vis a vis* sales tax incentives
- ◆ the applicability of VAT on works contract, lease transactions and hire-purchase transactions
- ◆ the deficiencies in the existing State - Level VAT regime in India

5.1 Basic concepts of VAT

(1) **What is VAT?:** Value added tax (VAT), as the term suggests, is a tax on the value added to the commodity at each stage in production and distribution chain. It is a system to collect the tax on the value at the final or retail point of sale. VAT is a consumption tax because it is borne ultimately by the final consumer.

Let us try to understand the concept of VAT with the help of an example.

Suppose, for manufacturing a product A, the manufacturer purchases four types of commodities B, C, D and E and pays excise duty on all of them. When ultimately he sells his manufactured product A, on which he has to discharge his liability towards excise, the excise duty leviable on such product is on a tax base which includes excise duties paid by the manufacturer on products B, C, D and E. Thus, the final excise duty is a duty on duty, which increases the cost of production as well as the price of the final product.

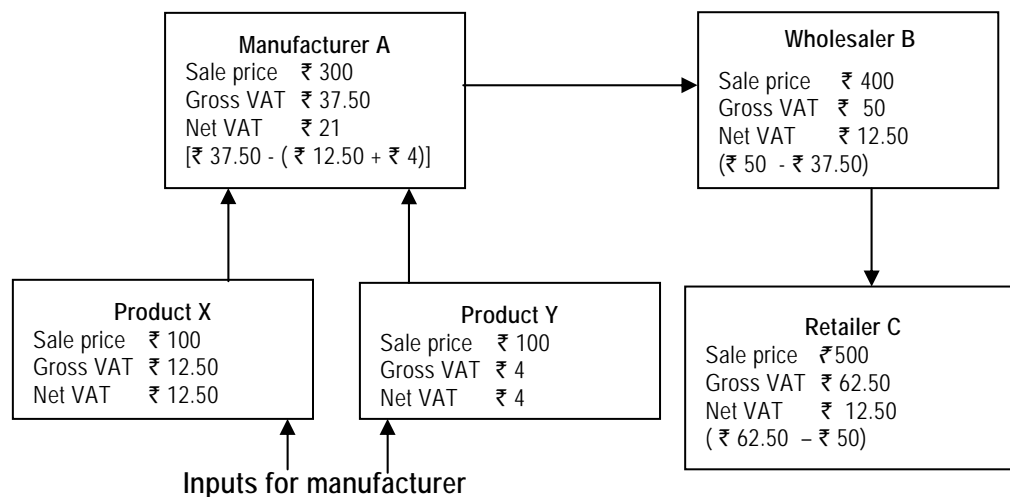
However, under VAT, the excise duties paid on commodities B, C, D and E are allowed to be set-off from the final duty liability on product A. Thus, the manufacturer avoids payment of duty on duty and the cost of the product is reduced, ultimately benefitting the consumer.

The above example is a case of value added tax on manufacture. In the same way, there can be a value added tax in respect of trading in commodities also. In case of VAT on sales, the

various taxes paid on inputs purchased will be allowed as a credit and set off against the tax liability on the value of sales of the commodity. In the same way, one can think of a system of VAT dealing with input and output services. The individual systems of manufacturing, sales and services VAT are ultimately combined to form a grand system of VAT on goods and services known as Goods and Services Tax.

(2) Cascading of taxes: As seen in the above example, in first case (non VAT), tax is levied on tax i.e., tax leviable at each stage is chargeable on a value which includes the tax paid at earlier stage as there is no credit of tax paid at earlier stage. This is termed as cascading effect of taxes which leads to increase in cost of production. However, in the second case (VAT), tax is not levied on tax paid at earlier stage; it is levied only on the value added as credit of tax paid at earlier stages is allowed to be set off against the tax payable at the next stage. Thus, VAT helps in eliminating cascading of taxes.

(3) How VAT operates: Value Added Tax (VAT) is levied as a proportion of the value added at each stage of production or distribution (i.e., sales minus purchase) which is equivalent to wages plus interest, other costs and profits. To illustrate, a chart of transactions is given below:



[Fig. 1]

Note: The rate of tax is assumed to be 12.5% on transactions relating to goods manufactured by A (i.e., on sales made by A, B and C).

For a manufacturer A, inputs are product X and product Y which are purchased from a primary producer. In practice, even these producers use inputs. For example, a farmer would use seeds, feeds, fertilizer, pesticides, etc. However, for this example, their VAT impact is not considered. B is a wholesaler and C is a retailer.

The inputs X and Y are purchased at ₹ 100 each on which tax is paid @ 12.5 % and 4% respectively. After adding wages, salaries and other manufacturing expenses to the cost of inputs, manufacturer A will also add his own profit. Assuming that after the addition of all these costs his sale price is ₹ 300, the gross tax (at the rate of 12.50%) would be

₹ 37.50. As manufacturer A has already paid tax on ₹ 200, he would get credit for this tax (i.e. ₹ 12.50 + ₹ 4 = ₹ 16.50). Therefore, his net VAT liability would be ₹ 21 only (₹ 37.50 minus ₹ 16.50) and because of this, he would take the cost of his inputs to be only ₹ 200.

Similarly, the sale price of ₹ 400 fixed by wholesaler B would have net VAT liability of ₹ 12.50 (₹ 50 - ₹ 37.50) and the sales price of ₹ 500 by retailer C would also have net VAT liability of ₹ 12.50 (₹ 62.50 - ₹ 50). Thus, VAT is collected at each stage of production and distribution process, and in principle, its entire burden falls on the final consumer, who does not get any tax credit. Hence, VAT is a broad-based tax covering the value added by each party to the commodity during the various stages of production and distribution.

(4) Variants of VAT

| Gross Product Variant | Income Variant | Consumption Variant |
|---|--|--|
| • Tax is levied on all sales and deduction for tax paid on inputs excluding capital goods is allowed. | • Tax is levied on all sales with set-off for tax paid on inputs and only depreciation on capital goods. | • Tax is levied on all sales with deduction for tax paid on all business inputs (including capital goods). |

[Fig. 2]

(a) **Gross Product Variant:** The gross product variant allows deductions for taxes paid on all purchases of raw materials and components, but no deduction is allowed for taxes paid on capital inputs.

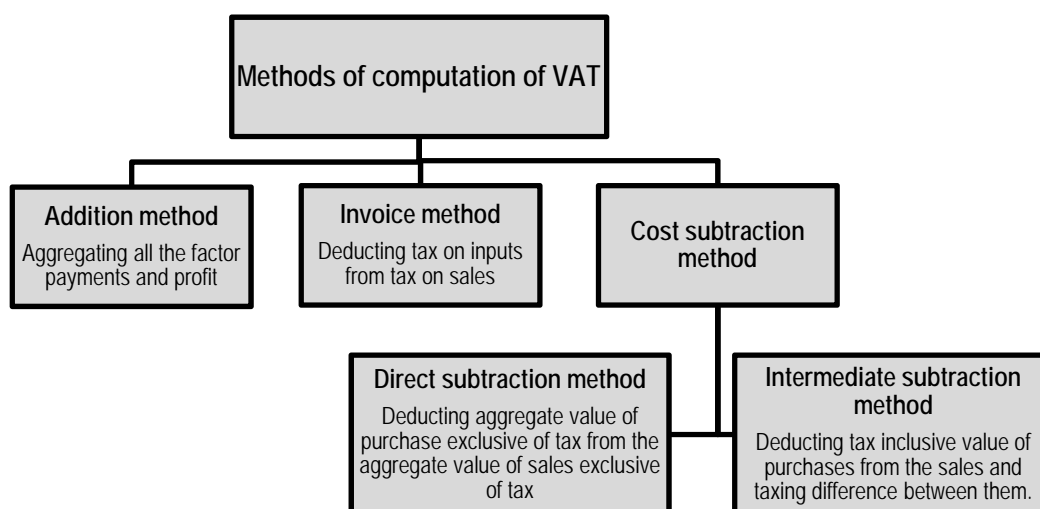
(b) **Income Variant:** The income variant of VAT on the other hand allows for deductions on purchases of raw materials and components as well as depreciation on capital goods. This method provides incentives to classify purchases as current expenditure to claim set-off.

(c) **Consumption Variant:** This variant of VAT allows deduction for all business purchases including capital assets. Thus, gross investment is deductible in calculating value added. It neither distinguishes between capital and current expenditures nor specifies the life of assets or depreciation allowances for different assets.

The consumption variant of VAT is the most widely used variant of the VAT. Several countries of Europe and other continents have adopted this variant as it does not affect decisions regarding investment because the tax on capital goods is also available for set-off against the VAT liability. Hence, the system is tax neutral in respect of techniques of production (labour or capital-intensive). It also simplifies tax administration by obviating the need to distinguish between purchases of inputs and capital goods.

In practice, therefore, most countries use the consumption variant. Also, most VAT countries include many services in the tax base. Since the business gets set-off for the tax on services, it does not cause any cascading effect.

(5) Methods of computation of tax



[Fig. 3]

(a) **Addition method:** This method aggregates all the factor payments (excluding value of material) including profits to arrive at the total value addition on which the tax rate is applied to calculate the tax. This type of calculation is mainly used with income variant of VAT. A drawback of this method is that it does not facilitate matching of invoices for detecting evasion as tax liability is calculated periodically and not invoice-wise.

(b) **Invoice method:** This is the most common and popular method for computing the tax liability under VAT system. Under this method, tax is imposed at each stage of sales on the entire sale value and the tax paid at the earlier stage (on purchases) is allowed as set-off. Thus, at every stage, differential tax is being paid. The most important aspect of this method is that at each stage, tax is to be charged separately in the invoice.

This method is very popular in western countries. In India also, this method is followed under the State Level VAT and the Central Excise Law. This method is also called the 'Tax Credit Method' or 'Voucher Method'.

Example:

| Stage | Particulars | VAT Liability (A) [₹] | VAT Credit (B) [₹] | Tax paid to Government (A) – (B) [₹] |
|-------|---|-----------------------|--------------------|--------------------------------------|
| 1. | Manufacturer/first seller in the State sells the goods to distributor for ₹ 1000. Rate of tax is 12.5%. Therefore, his tax liability will be ₹ 125. He will not get any VAT credit, being the first seller. | 125 | - | 125 |
| 2. | Distributor sells the goods to a wholesale | 150 | 125 | 25 |

1.125 Indirect Taxes

| | | | | |
|----|--|---------------|---------------|------------|
| | dealer for say ₹ 1200 @ 12.50% and will get set-off of tax paid at earlier stage at ₹ 125. The tax payable by him will be ₹ 25. | | | |
| 3. | Wholesale dealer sells the goods to a retailer at say ₹ 1500. Here again, he will have to pay the tax on ₹ 1500. He will get credit of tax paid at earlier stage of ₹ 150. The tax payable by him will be ₹ 37.50. | 187.50 | 150 | 37.50 |
| 4. | Retailer sells the goods to consumers at say ₹ 2000. Here again, he will have to pay tax on ₹ 2000. He will get credit for tax paid earlier at ₹ 187.50. The tax payable by him will be ₹ 62.50. | 250 | 187.50 | 62.50 |
| | Total | 712.50 | 462.50 | 250 |

Thus, the Government will get tax on the final retail sale price of ₹ 2,000. However, the tax will be paid in installments at different stages. At each stage, tax liability is worked out on the sale price and credit is also given on the basis of tax charged in the purchase invoice. If the first seller is a manufacturer, he gets the credit of tax paid on raw materials, etc. which are used in the manufacturing.

From the above illustration, it is clear that under this method, tax credit cannot be claimed unless and until the purchase invoice is produced. As a result, in a chain, if at any stage the transaction is kept out of the books, still there is no loss of revenue. The Government can recover the full tax at the next stage. Thus, the possibility of tax evasion, if not entirely ruled out, is reduced to a minimum. However, proper measures are required to prevent the production of fake invoices to claim credit of tax paid at an earlier stage.

It is said that in this method, the beneficiary is the trade and industry because in the above example, the total tax collection at all the stages is ₹ 712.50 whereas tax received by the State is only ₹ 250.

(c) Cost subtraction method: Under this method, tax is charged only on the value added at each stage of the sale of goods. Since, the total value of goods sold is not taken into account, the question of grant of claim for set-off or tax credit does not arise. Further, under this method tax cannot be shown separately in invoice and tax liability can only be calculated periodically. Since, tax payable on a product is not known, end-use based exemption cannot be given under this method.

For imposing tax, 'value added' is simply taken as the difference between sales and purchases.

Tax is calculated by the formula $\frac{T \times R}{100 + R}$, where T = Taxable turnover and R = Rate of Tax.

This method is suitable for gross product variant.

Example:

| Stage | Particulars | Turnover for tax under VAT | Tax @ 12.50% |
|-------|---|----------------------------------|---|
| | | (₹) | (₹) |
| 1. | First seller sells the goods to a distributor at ₹ 1,125 inclusive of tax. | 1,125 | 125 $\left[\frac{(1125 \times 12.50)}{100 + 12.50} \right]$ |
| 2. | Distributor sells the goods to a whole-seller at ₹ 1,350. Here, taxable turnover will be ₹ 1,350 - ₹ 1,125. | 225 | 25 $\left[\frac{(225 \times 12.50)}{100 + 12.50} \right]$ |
| 3. | Wholesaler sells the goods to a retailer at say, Rs 1,687.50. Here, taxable turnover will be ₹ 1,687.50 - ₹ 1,350 | 337.50 | 37.50 $\left[\frac{(337.50 \times 12.50)}{100 + 12.50} \right]$ |
| 4. | Retailer selling the goods at say, ₹ 2250. Taxable turnover will be ₹ 2250 - ₹ 1687.50 | 562.50 | 62.50 $\left[\frac{(562.50 \times 12.50)}{100 + 12.50} \right]$ |
| | | 2,250 | 250 |

Thus, under this system also, tax is charged at each stage and the incidence of tax on the final sale price to the consumer remains the same as in the invoice method. However, this holds good till the time the same rate of tax is attracted on all inputs, including consumables and services, added at all the stages of production/distribution. If the rates are not common, then the final tax by the two methods may differ. This is explained through the examples given below.

Example:**All inputs taxable at ONE rate**

| Invoice method | | | | | |
|------------------------|----------------------|-----------------------|------------|-------------------------|---------------------|
| Particulars | Invoice value [₹] | Material value [₹] | VAT [₹] | Input tax credit [₹] | Net VAT paid [₹] |
| Inputs for A | | | | | |
| Product X @ 12.50% | 260 | 231 | 29 | -- | 29 |
| Product Y @ 12.50% | 450 | 400 | 50 | -- | 50 |
| | ----- | ----- | ----- | ----- | ----- |
| | 710 | 631 | 79 | -- | 79 |
| 'A' sells goods to 'B' | 1125 | 1000 | 125 | 79 | 46 |
| 'B' sells goods to 'C' | 1800 | 1600 | 200 | 125 | 75 |
| 'C' sells goods to 'D' | 2250 | 2000 | 250 | 200 | 50 |
| 'D' sells goods to 'E' | 2700 | 2400 | 300 | 250 | 50 |
| FINAL | 2700 | 2400 | 300 | -- | 300 |

| Subtraction method | | | | |
|--------------------|-------------------|--------------------|-----------------|------------------|
| Particulars | Invoice value [₹] | Purchase price [₹] | Value added [₹] | VAT @ 12.50% [₹] |
| Inputs for A | 710 | -- | -- | 79 |
| 'A' to 'B' | 1125 | 710 | 415 | 46 |
| 'B' to 'C' | 1800 | 1125 | 675 | 75 |
| 'C' to 'D' | 2250 | 1800 | 450 | 50 |
| 'D' to 'E' | 2700 | 2250 | 450 | 50 |
| FINAL | 2700 | -- | -- | 300 |

| Inputs taxable at DIFFERENT rates | | | | | |
|-----------------------------------|-------------|--------------------|---------|----------------------|------------------|
| Invoice method | | | | | |
| Particulars | Invoice [₹] | Material Value [₹] | VAT [₹] | Input tax credit [₹] | Net VAT paid [₹] |
| Inputs for A | | | | | |
| Product X @ 4% | 260 | 250 | 10 | -- | 10 |
| Product Y @ 12.5% | 450 | 400 | 50 | -- | 50 |
| | ----- | ----- | ----- | ----- | ----- |
| | 710 | 650 | 60 | -- | 60 |
| 'A' sells goods to 'B' | 1125 | 1000 | 125 | 60 | 65 |
| 'B' sells goods to 'C' | 1800 | 1600 | 200 | 125 | 75 |
| 'C' sells goods to 'D' | 2250 | 2000 | 250 | 200 | 50 |
| 'D' sells goods to 'E' | 2700 | 2400 | 300 | 250 | 50 |
| FINAL | 2700 | 2400 | 300 | -- | 300 |

| Subtraction method | | | | |
|--------------------|-------------|--------------------|-----------------|------------------|
| Particulars | Invoice [₹] | Purchase Price [₹] | Value Added [₹] | VAT @ 12.50% [₹] |
| Inputs for A | 710 | -- | -- | 60 |
| 'A' to 'B' | 1125 | 710 | 415 | 46 |
| 'B' to 'C' | 1800 | 1125 | 675 | 75 |
| 'C' to 'D' | 2250 | 1800 | 450 | 50 |
| 'D' to 'E' | 2700 | 2250 | 450 | 50 |
| FINAL | 2700 | -- | -- | 281 |

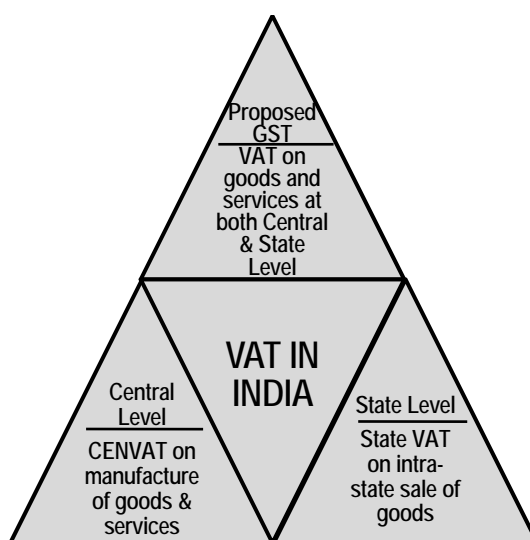
Thus, on the same consumer price of ₹ 2700, under invoice method, VAT works out to be ₹ 300 whereas under the subtraction method it works out to be ₹ 281. Therefore, this method is not considered as a good method.

(6) Merits and Demerits of VAT

| S. No. | Merits | Demerits |
|--------|---|--|
| 1. | Reduced tax evasion: Even if tax is evaded at one stage, the transaction gets caught in next stage of production or distribution. | Distortions in case of exemptions/concessions: The merits accrue in full measure only where there is one rate of VAT and the same applies to all commodities without any question of exemptions whatsoever. Once concessions like differential rates of VAT, composition schemes, exemption schemes, exempted category of goods etc. are built into the system, distortions are bound to occur. |
| 2. | Increased tax compliance: VAT acts as a self-policing mechanism as the buyer can get credit of tax paid only if the seller issues the invoice showing tax and thus, the buyer insists on getting the invoice from the seller, thereby acting as a police for the seller. | Increased compliance cost: The detailed accounting and the paper work required for complying with the VAT system increases the compliance cost which may not always commensurate with the benefit to traders and small firms. |
| 3. | Certainty: VAT brings certainty owing to its simple tax structure and minimum variations. | Increased working capital requirements: Since tax is to be imposed or paid at various stages and not on last stage, it increases the working capital requirements and the interest burden on the same. Thus, it is considered to be non-beneficial in comparison with single stage-last point taxation system. |
| 4. | Transparency: As the tax charged has to be shown clearly in the invoice, the system becomes transparent with no hidden taxes. | Consumption favoured over production: Since, VAT is a consumption based tax, it is collected by the State consuming the goods. Thus, States where consumption is higher tend to get more revenue than States where production is higher. |

| | | |
|----|--|---|
| 5. | Cheaper exports: Exports get cheaper as taxes paid at earlier stages could be availed as credit or refunded in cash. | Tax evasion through bogus invoices: Since input tax credit can be availed on the basis of invoices, dealers try to claim tax credit on the basis of fake invoices – where no purchases has been made - thereby causing loss of revenue to the exchequer. |
| 6. | Better accounting systems: Since the tax paid at the earlier stage is to be received back, the system promotes better accounting systems. | Regressive tax: Burden of VAT falls disproportionately on the poor since the poor are likely to spend more of their income than the relatively rich person. |
| 7. | Neutrality: Since tax credit of both inputs and capital goods is available, there is no distinction between labor intensive and capital intensive industries. | |

5.2 VAT in Indian context



[Fig. 4]

(1) **CENVAT:** In India, VAT was introduced for the first time in the year 1986 as Modified VAT (MODVAT) in case of manufacture of goods. The same was subsequently changed to Central VAT (CENVAT) in the year 2000. VAT was introduced in case of services in the year 2002 and the same was subsequently integrated with CENVAT in the year 2004. Thus, excise duty paid on inputs/capital goods and service tax paid on input services could be availed as credit for being set off against the manufacturer's excise duty liability or a service provider's

service tax liability¹.

(2) State-Level VAT: After the introduction of VAT in the area of manufacture and services, a need arose to introduce a similar system in the area of sales tax as the erstwhile sales tax regime had become highly complex due to multiple taxes, cascading effect, varying rates of sales tax on different commodities in different States leading to unhealthy competition among the States often resulting in counter-productive situations.

It is in this background that attempts were made to introduce a harmonious VAT in the States. In view of the Constitutional constraints (Central Government is empowered to levy tax on goods and services while tax on sales is a State subject), CENVAT could not be extended to sales tax. Therefore, the Central Government constituted an Empowered Committee of State Finance Ministers chaired by Dr. Asim Dasgupta to consider introduction of State-Level VAT. Finally, State-Level VAT was introduced on 01.04.2005 by majority of the States, though few States had already implemented it by that time.

State-Level VAT replaced the erstwhile sales tax system and marked a significant step forward in the reform of domestic trade taxes in India. After overcoming the initial difficulties, all the States and Union Territories implemented VAT. Trade and industry also responded well to the reform. The rate of growth of tax revenue nearly doubled from the average annual rate of growth in the pre-VAT five year period after the introduction of VAT.

Introduction of VAT in the States has been a more challenging exercise in a federal country like India, where each State, in terms of Constitutional provisions, is sovereign in levying and collecting State taxes. State-Level VAT has addressed the distortions and complexities associated with the levy of tax at the first point of sale under the erstwhile system and resulted in a major simplification of the rate structure and broadening of the tax base.

Thus, at present, VAT is operational in India as CENVAT (central level) in case of manufacture of goods and rendition of services and as State-Level VAT in the case of sale of goods.

White Paper on State-Level VAT in India: The Empowered Committee of State Finance Ministers brought out a White paper on State-Level VAT in India on 17.01.2005, which provided a base for the preparation of various State VAT legislations. Considering that VAT is a State subject, the States had freedom for making appropriate variations consistent with the basic design as agreed upon at the Empowered Committee. Broadly, the White Paper consists of the following:

- (a) Justification of VAT and Background
- (b) Design of State-Level VAT
- (c) Steps taken by the States

All the State VAT legislations passed by the States have incorporated the principles of State-Level VAT as contained in the White Paper. However, each State has made changes as per its needs.

¹ The concept of CENVAT credit available on goods and services has been discussed in Chapter-7 of this Study Material.

No model law for all States: Though the basic concepts of State-Level VAT are same in all States, tax on sales being a State subject, the provisions of VAT Acts of different States differ from State to State. For instance, provisions in respect of credit allowable, credit of tax on capital goods and the like are not uniform. Further, definitions of terms like 'business', 'sale', 'sale price', 'goods', 'dealer', 'turnover', 'input tax' etc. are also not uniform. Though as per the design of State-Level VAT set out in the White Paper, tax rates were expected to be uniform broadly, the tax rates on various articles differ from State to State.

The concepts relating to VAT dealt in subsequent pages of this Unit are based on the principles laid down by the White Paper on State-Level VAT. It may be noted that the discussion in this Unit is not based on the provisions of any particular State VAT Act.

(3) Goods and Service Tax: Despite the introduction of value added tax in India - at the Central level in the form of CENVAT and at the State level in the form of State VAT - its application has remained piecemeal and fragmented on account of the following reasons:

- (a) Problems relating to distinguishing between goods and services have been a major cause of concern in service taxation as the distinction between the two is often blurred.
- (b) Non-inclusion of several State and local levies in State VAT such as luxury tax, entertainment tax, etc.
- (c) Cascading effect of taxes as CENVAT on the goods remains included in the value of goods taxed under State VAT.
- (d) No integration of VAT on goods with tax on services at the State level.
- (e) Continued imposition of the central sales tax (CST), which is non-vatable, leads to cascading effect thereby adding to the cost of goods.

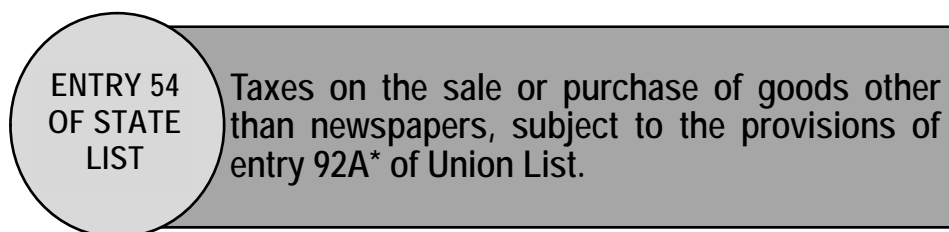
With a view to mitigate such problems, the then Finance minister, Mr. P. Chidambaram, in Union Budget 2006-07 proposed the roll out of India's most ambitious indirect tax reform namely, Goods and Service Tax (GST). GST seeks to attain a comprehensive and harmonized tax structure in a federal State like India. It is aimed at creating a common domestic market, removing multiplicity of taxes, eliminating cascading effect of tax on tax, making the prices of the Indian products competitive and, above all, benefiting the end consumers. A dual model has been proposed for GST in India so that both Central and State Governments can collect taxes to raise resources to fulfill their sovereign obligations/ duties. GST will subsume most of the indirect taxes being levied in India including central sales tax (CST).

GST would integrate goods and service taxes for the purpose of set-off relief. Simultaneous introduction of GST at the State level will ensure that both the cascading effects of CENVAT and service tax are removed with set-off, and a continuous chain of set-off from the original producer's point and service provider's point up to the retailer's level is established which reduces the burden of all cascading effects. However, for the GST to be introduced at the State level, it is essential that the States should be given the power to levy tax on services. This power of levy of service taxes has so long been only with the Centre. A Constitutional Amendment is proposed for giving this power to the States as well.

Though, introduction of GST in India is a very arduous task as it requires amendment of the Constitution of India and consensus between Central and States Governments on variety of issues like rates, basic threshold, exemptions, classification, administration; it is expected to give a major relief to industry, trade, agriculture and consumers through a comprehensive and wider coverage of input tax set-off and service tax set-off, subsuming of multiple taxes and phasing out of CST.

5.3 Constitutional provisions relating to State-Level VAT

As learned before, tax on intra-state sale or purchase of goods is a State subject. Therefore, State Governments levy VAT under the authority of **Entry 54 of the State List** which reads as under:-



[Fig. 5]

*[*Central Government levies CST by virtue of Entry 92A of the Union List]*

It is important to note that State Governments are not empowered to levy tax on intra-state sale or purchase of newspapers. You may also recollect that inter-state sale or purchase of newspapers is also not liable to central sales tax. Thus, sale or purchase of newspapers, whether inter-state or intra-state, is not liable to any type of tax.

(1) What is tax on sale or purchase of goods?: Clause (29A) of the Article 366 of the Constitution defines the term "tax on sale or purchase of goods". The definition is an inclusive one and it lays down six specific instances of deemed sale i.e., cases which are not sales in traditional sense but have been deemed to be sales for the purpose of levability of CST/VAT. These deemed sales encompass elements of both goods as well as services. The goods portion is chargeable to CST/VAT and on services portion, service tax is imposed. This aspect has been discussed in detail in Unit 4 of this Chapter.

(2) What is sale?: Sale means-

- (a) any transfer of property in goods by one person to another for cash or deferred payment or for any other valuable consideration; and
- (b) includes "deemed sales" transactions under Article 366(29A) of the Constitution of India; but
- (c) does not include a mortgage or hypothecation of, or a charge or pledge on, goods.

(3) What are goods?:

- (i) **As per Sale of Goods Act, 1930:** As per section 2(7) of the Sales of Goods Act, 1930, 'goods' means-

- (a) every kind of movable property other than actionable claims and money and
- (b) includes stocks and shares, growing crops, grass and things attached to and forming part of the land, which are agreed to be severed before sale or under the contract of sale.

(ii) **As per Central Sales Tax Act, 1956:** Section 2(d) of CST Act defines that 'goods' includes all materials, articles, commodities and all kinds of movable property, but does not include newspapers, actionable claims, stocks, shares and securities.

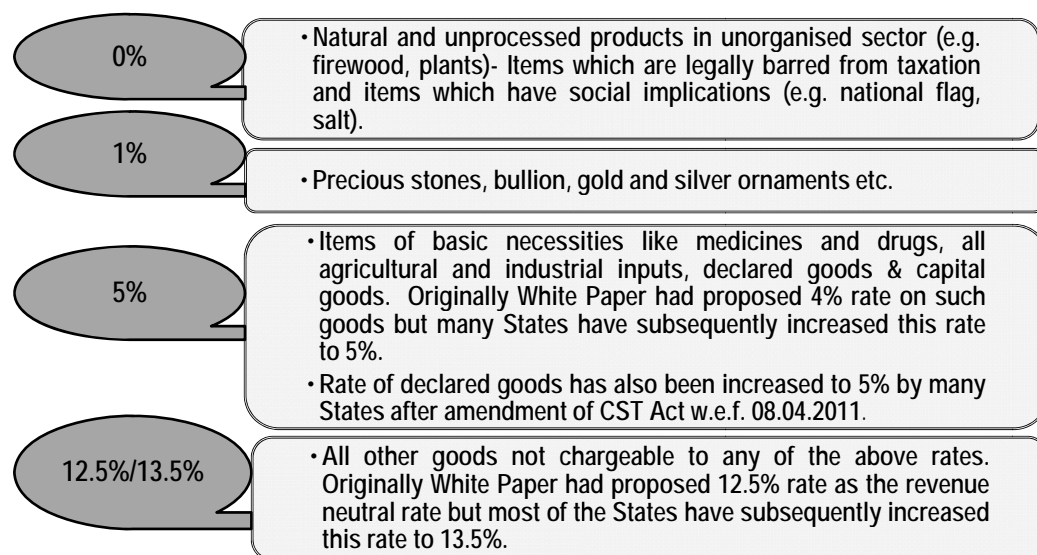
Though each State has its own definition of 'goods' but broadly, the definitions are similar to the definition provided under the CST Act.

The following points merit consideration in this regard:

- Goods may be tangible (like computer, pen, pencil etc.) as well as intangible (like patent, copyright).
- Goods include all kinds of movable property, but not newspapers, actionable claims, stocks, shares and securities.
- Plant and machinery erected at site, being immovable property, is not goods.
- Electricity is goods but lottery ticket, being actionable claim, is not goods.
- Software (branded as well as unbranded) is goods.

5.4 VAT rates and coverage of goods

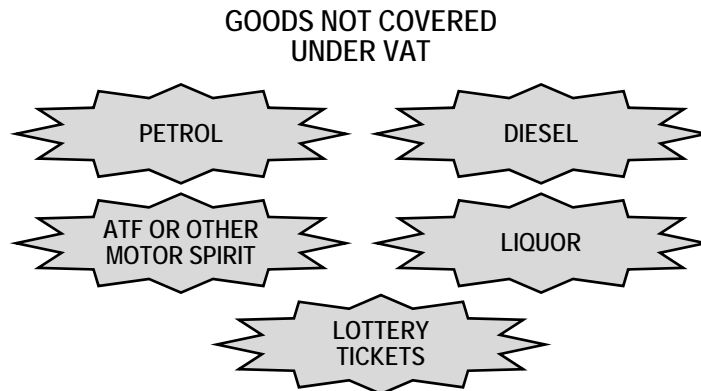
(1) **VAT rates:** In order to do away with the demerits of multiple rates prevalent under sales tax regime, minimum number of rates were recommended in the White Paper. However, States have deviated from the prescribed rates. The prevalent common tax rates are:



[Fig. 6]

Largely, all States follow the above rate structure, but still there are many variations.

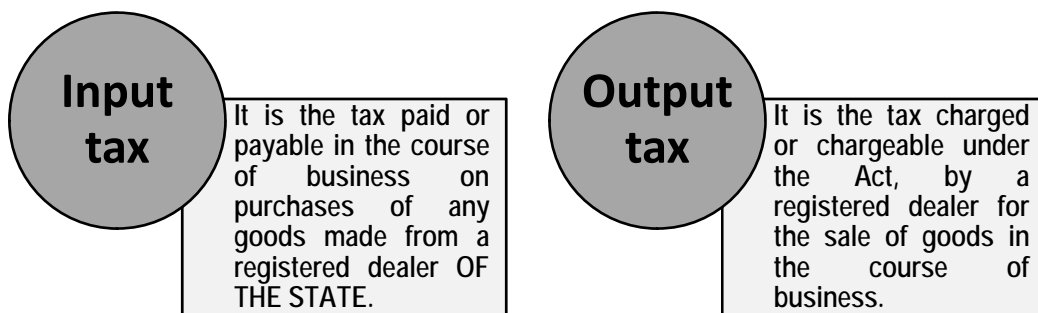
(2) **Coverage of goods under VAT:** As per the White Paper, generally, all the goods, including declared goods will be covered under VAT and get the benefit of input tax credit.



[Fig. 7]

The few goods which will be outside VAT will be liquor, lottery tickets, petrol, diesel, aviation turbine fuel and other motor spirit since their prices are not fully market determined. Though sale of liquor, petrol, diesel and aviation turbine fuel (ATF) is charged to tax under VAT laws in many States, taxes paid on them are not allowed as credit to the buyer. In other words, they are outside the VAT chain. ATF and petroleum products are liable to minimum 20% VAT in most of the States.

5.5 Input tax and output tax



[Fig. 8]

In simple words input tax is the tax paid by a dealer on local purchases of business inputs, which include goods that he purchases for resale, raw materials, capital goods as well as other inputs for being used directly or indirectly in his business. Output tax is the tax charged by a dealer on his sales that are subject to tax.

Example: 'A' purchases inputs valuing ₹ 1,000 chargeable to VAT @ 12.5%. In this case, ₹ 125 paid by 'A' as VAT is input tax for 'A'.

When 'A' sells goods manufactured from such inputs to 'B' at ₹ 2,000 chargeable to VAT @ 12.5%, ₹ 250 collected by 'A' from 'B' is the output tax for 'A' while the same is input tax for 'B'.

Thus, it is clear that CST cannot be an input tax as it is leviable on purchases made by the dealer from outside the State. Likewise, custom duty paid on imported inputs cannot also be an input tax as it is leviable on purchases made by the dealer from outside the country.

5.6 Input tax credit (ITC)

The essence of VAT is in providing set-off for the tax paid earlier, and this is given effect through the concept of input tax credit/rebate. Input tax credit in relation to any period means setting off the amount of input tax by a registered dealer against the amount of his output tax. Thus, CST paid on purchases made from outside the State cannot be claimed as input tax credit.

(1) CST is not Vatable: Let us try to understand why CST is not Vatable with the help of the following example:

Example: A dealer of Karnataka purchases goods from another dealer of Maharashtra. The Maharashtra dealer charges CST @ 2% on this sale against the 'C' form produced by the dealer of Karnataka. The tax is deposited in the treasury of Maharashtra and thus, forms part of Maharashtra's revenue. Though its name is central sales tax but the Central Government does not get any part of this revenue and it is totally a revenue receipt of the selling state. The Karnataka dealer later sells these goods in the State of Karnataka to any other dealer or consumer and collects VAT on the same.

Now the question arises whether the Karnataka dealer can claim input tax credit of the CST paid by him against his VAT liability. The answer is no as Karnataka (purchasing State) would not allow set off of a tax paid in Maharashtra (another State).

However, when liability of CST arises on an inter-state sale, input tax credit can be used for set off as the revenue in this case does not go to any other State.

CST leads to cascading of taxes: India has a purely unbalanced State wise economy as only some of the States are manufacturing States while majority of them are consumer states. Manufacturing States generate considerable revenues from CST. When goods purchased from manufacturing States (with CST imposed on them) are resold in these States, the tax liability of non-manufacturing States becomes very high on account of VAT and CST.

(2) Coverage of ITC: Input tax credit is available in respect of input tax paid on purchase of inputs and capital goods.

(i) Inputs: ITC is allowed to a registered dealer for purchase of any goods made within the State from a dealer holding a valid certificate of registration under the Act. Further, the ITC is given to both manufacturers and traders for purchase of inputs/supplies meant for both sale within the State as well as to other States, irrespective of when these will be utilized/sold.

(ii) **Capital goods:**

- (a) **Meaning of capital goods:** Capital goods include plant and machinery, furniture, fixture, electrical installations, vehicles etc. (other than raw material) purchased by the registered dealer or manufactured by the registered dealer himself. Input tax paid on purchase of capital goods as also on the raw materials used for manufacturing the capital goods, is eligible for ITC.
- (b) **Need of ITC for input tax paid on capital goods:** By extending ITC on capital goods, the cascading effect of taxes (tax on tax) is avoided. If VAT paid on capital goods is allowed as ITC, depreciation is claimed on the value excluding VAT. This reduces the cost and ultimately, the selling price.
- (c) **Policy in White Paper:** ITC on capital goods is also available for traders and manufacturers. Tax credit on capital goods can be adjusted over a maximum of 36 equal monthly installments. The States can, at their option, reduce the number of installments.

For instance, in Maharashtra full ITC on capital goods is available in the month of purchases itself. However, if the capital asset is sold within the period of 36 months, proportionate ITC is withdrawn.

There is a negative list of capital goods (on the basis of principles already decided by the Empowered Committee) not eligible for input tax credit.

The allowable set off on capital goods is part of normal set off. The dealer can adjust this set off against his other VAT liability.

(3) Purchases eligible for availing input tax credit: For the purpose of claiming ITC, the taxable goods should be purchased for any one of the following purposes-

- (i) for sale/resale within the State;
- (ii) for sale to other parts of India in the course of inter-State trade or commerce;
- (iii) to be used as-
 - (a) containers or packing materials;
 - (b) raw materials; or
 - (c) consumable stores,

required for the purpose of manufacture of taxable goods or in the packing of such manufactured goods intended for sale in the State or in the course of inter-State trade or commerce;
- (iv) for being used in the execution of a works contract;
- (v) to be used as capital goods required for the purpose of manufacture or resale of taxable goods;
- (vi) to be used as
 - (a) raw materials;

- (b) capital goods;
- (c) consumable stores and
- (d) packing materials/containers

for manufacturing/packing goods to be sold in the course of export out of the territory of India;

(vii) for making zero-rated sales other than those referred to in clause (vi) above.

(4) Purchases not eligible for input tax credit: ITC may not be allowed in the following circumstances-

- (i) purchases from unregistered dealers *[as he cannot charge VAT];*
- (ii) purchases from registered dealer who opts for composition scheme *[Concepts relating to Composition Scheme have been discussed under Heading 5.8 of this Unit.]*
- (iii) purchase of goods as may be notified by the State Government;
- (iv) purchase of goods where the purchase invoice is not available with the claimant or there is evidence that the same has not been issued by the registered selling dealer from whom the goods are purported to have been purchased;
- (v) purchase of goods where invoice does not show the amount of tax separately;
- (vi) purchase of goods for being utilized in the manufacture of exempted goods or purchase of goods when the sales are exempt *[However, in some States partial input tax credit is available even when sales are exempt];*
- (vii) purchase of goods for personal use/consumption or to be provided free of charge as gifts, free samples *[partial credit is available in the State of Maharashtra];*
- (viii) purchase of goods like motor vehicles, toilet articles, furniture etc. which are not used in relation to production of goods or held for sale/resale;
- (ix) goods imported from outside the territory of India;
- (x) goods purchased from other States viz. inter-state purchases.

Some special aspects:

- **One to one co-relation not required:** VAT does not require bill to bill co-relation between input and output. It is not necessary to ensure that ITC of only those inputs which are actually utilized in the manufacture of the output is being set off against the output tax liability. ITC can be utilized for payment of VAT on any output without waiting for the input to be actually consumed/sold. Thus, ITC is available as soon as inputs/capital goods are purchased [In case of capital goods, some States allow ITC in specified installments].
- **ITC in case of exports and inter-state sale:** Whereas input tax credit is available on goods meant for export or inter-state sale, the same cannot be availed on goods purchased from outside India or outside the State.

- **ITC allowed only if VAT paid by the seller:** Input tax credit is allowed only to the extent of tax received by the State Government from the seller. Therefore, the purchasing dealer, desirous of claiming set off, should also look into the credentials of the vendor so as to be sure that he will get the set off of tax paid to him.
- **Proportionate ITC in case of goods partially used for taxable goods:** As learned before, ITC is allowed only if the goods are used for manufacture etc. of taxable goods and no credit is allowed for goods used in manufacture of tax free/exempted goods. Taxable goods are other than tax-free goods.

However, where the purchased goods are used partially for the purpose of taxable goods, input tax credit is allowed proportionate to the extent the purchases are used for the purposes of taxable goods. Thus, credit relating to the goods used in manufacture of exempted goods has to be reversed.

Example: A manufacturer purchases 50 kg of raw material worth ₹ 10,000 and pays ₹ 1250 VAT on it. While 20 kg of the raw material is used for manufacture of taxable goods, the remaining is used for exempted goods. Thus, ITC of ₹ 500 (ITC proportionate to the raw material being used in manufacture of taxable goods) can only be allowed.

- **Stock transfer:** Transfer of goods from one branch to another or consignment transfers are not liable to VAT or CST as they do not involve sale. Whereas entire ITC is allowed in case of transfer of goods within the State, partial ITC is allowed in case of inter-state transfer of goods. The tax paid in excess of 2% on

(i) inputs used in the manufacture of finished goods which are stock transferred; or

(ii) purchase of goods which are stock transferred

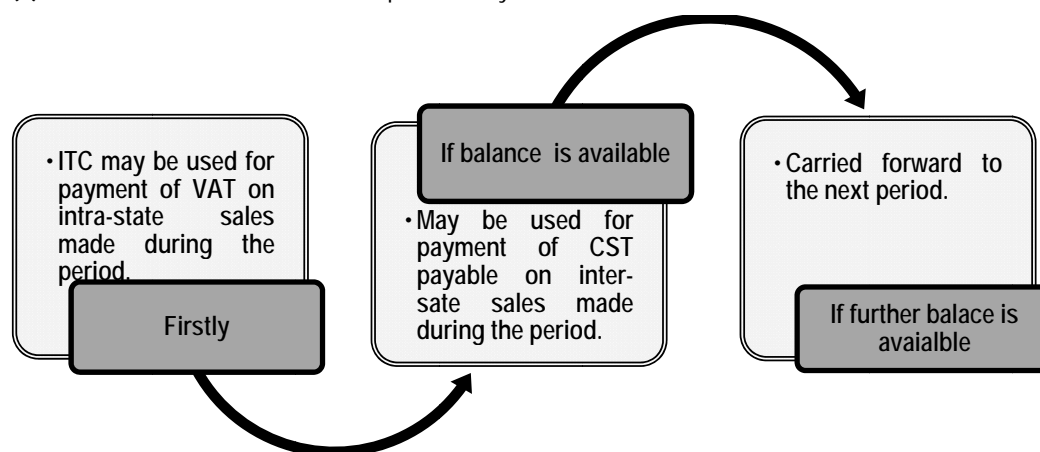
to another State is available as input tax credit.

Example: If goods worth ₹ 2,000 chargeable to VAT @ 12.5% are stock transferred to a branch in another State, then ₹ 40 [2% of ₹ 2,000] would be retained and balance ₹ 210 would be available as credit.

- **Exempted goods v. zero rated goods:** In case of zero rated sales, VAT is not payable on final products in certain specified circumstances but input tax credit can be availed on the inputs. For example, exports are zero rated. In such a case, ITC can be utilized for payment of VAT on taxable goods sold within India. If the exports of the dealer are more than his taxable sale within India, he can get refund of the ITC available with him.

However, if goods are exempted goods, then ITC on inputs used in the manufacture thereof is not allowed.

(5) **Utilization of ITC:** ITC of a period may be used as under-



[Fig. 9]

(6) **Carrying over of tax credit:** As explained above, input tax credit is first to be utilized for payment of VAT. The excess credit can be then adjusted against the CST for the said period. After the adjustment of VAT and CST, excess credit, if any, will be carried over to the end of the next year. If there is any excess unadjusted input tax credit at the second year, then the same will be eligible for refund. However, some States grant refund at the end of the first financial year itself.

(7) **Refund of input tax / exemption from input tax:**

- **Refund within three months in case of exports:** The White Paper provides for the grant of refund of input tax paid if the goods are exported out of the country. Under the basic design of the White Paper, this refund is to be granted within a period of 3 months from the end of the period in which the transaction for export took place.
- **Exemption/refund to SEZ and EOU Units:** Units located in Special Economic Zone (SEZ) and Export Oriented Units (EOU) are granted either exemption from payment of input tax or refund of the input tax paid within three months. State Governments may reduce the time period of 3 months.
- **Reimbursement of tax to UNO and Embassies:** In some of the States, the specialized agencies of the United Nations Organization and Consulates and also Embassies of any other countries located in the State get the reimbursement of tax paid subject to fulfillment of conditions.

(8) **Refund of special CVD paid on goods imported by a trader:** Manufacturers in India are allowed to avail CENVAT credit of special CVD paid on imported goods used in the manufacture of final products. The special CVD is leviable @ 4% on imported goods in lieu of VAT *[Special CVD has been discussed in detail in Unit 3 of this Chapter]*.

However, a trader importing goods for further sale in India can claim refund of the special CVD paid by him, if he -

- charges VAT on further sale of such imported goods and

- mentions in the VAT invoice issued by him that the buyer will not be able to avail CENVAT credit of such duty.

5.7 VAT liability

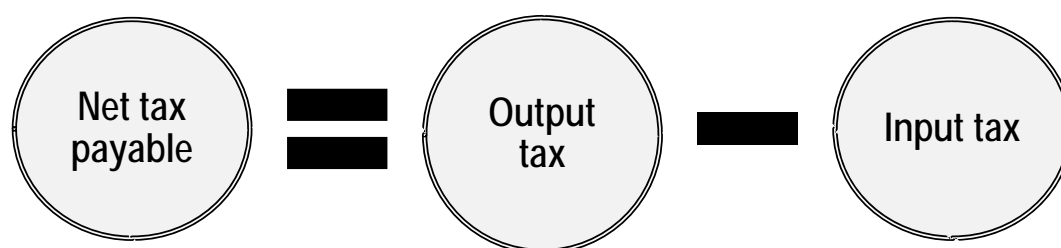
Value Added Tax (VAT) is based on the value addition to the goods, and the related VAT liability of the dealer is calculated by deducting input tax credit from output tax payable i.e., tax collected on sales during the payment period (say, a month).

Subject to the provisions relating to credit for input tax, the net tax payable by a taxable person for a tax period can be calculated on the basis of the following formula:

Net tax payable = A – B, where

A = Total of the tax payable in respect of taxable supplies made by the taxable person during the tax period and

B = Total input tax credit allowed to the taxable person for the tax period.



[Fig. 10]

Example: A is a trader selling raw materials to a manufacturer of finished products. He imports his stock-in-trade as well as purchases the same in the local markets and sells the entire product to B.

| Sl. No. | Particulars | ₹ |
|---------|--|---------------|
| (i) | A's cost of imported materials (A has deposited ₹ 1250 duty on the above. Since, this is not a State VAT it will form cost of the input) | 11,250 |
| (ii) | A's cost of local materials (VAT charged by local suppliers ₹ 2,500. Since the credit of this would be available, it will not be included in cost of input) | 20,000 |
| (iii) | Other expenditure (such as for storage, transport, etc.) incurred and profit earned by A | <u>8,750</u> |
| (iv) | Sale price of goods | 40,000 |
| (v) | VAT on the above @ 12.50% | <u>5,000</u> |
| (vi) | Invoice value charged by A to the manufacturer, B | <u>45,000</u> |

1.141 Indirect Taxes

A's VAT liability will be determined as under:

| I. | A's liability for VAT | | ₹ |
|----|--|--------------|---------------------|
| | Tax on the sale price | | 5,000 |
| | Less: Set-off of VAT paid on purchases | | |
| | On imported goods | Nil | |
| | On local goods | <u>2,500</u> | <u>2,500</u> |
| | Net Tax Payable | | <u>2,500</u> |

Now B manufactures finished products from the raw materials purchased from A and other materials purchased from other suppliers. The following would be the position in his case

| Sl. No. | Particulars | | ₹ |
|---------|--|--|-----------------|
| (i) | B's cost of raw materials (VAT available set off ₹ 5,000) | | 40,000 |
| (ii) | B's cost of other materials | | |
| | Local Purchases (VAT charged on the above ₹ 2,500) | | 20,000 |
| | Inter- State Purchases* (CST paid ₹ 400) | | 10,400 |
| (iii) | Manufacturing and other expenses incurred and profit earned by B | | <u>29,600</u> |
| (iv) | Sale price of finished product | | 1,00,000 |
| (v) | VAT on the above @ 12.5% | | <u>12,500</u> |
| (vi) | Invoice value charged by B to the wholesaler, C | | <u>1,12,500</u> |

*Credit / set off for tax paid on inter-State purchases (inputs) is not allowed.

| II. | B's liability for VAT | ₹ | ₹ |
|-----|--|--------------|---------------------|
| | Tax on the sale price | | 12,500 |
| | Less: Set-off of VAT paid on purchases | | |
| | To A | 5,000 | |
| | To other suppliers | <u>2,500</u> | <u>7,500</u> |
| | Net Tax Payable | | <u>5,000</u> |

When C, after repacking the goods into other packing boxes, sells the finished product to a retailer, following would be the position:

| Sl. No. | Particulars | | ₹ |
|---------|--|--|-----------------|
| (i) | C's cost of goods (VAT paid available as set off ₹ 12,500) | | 1,00,000 |
| (ii) | Cost of packing material (VAT charged on the above ₹ 250) | | 2,000 |
| (iii) | Expenses incurred and profit earned by C | | <u>18,000</u> |
| (iv) | Sale price of goods | | 1,20,000 |
| (v) | VAT on the above @ 12.5% | | <u>15,000</u> |
| (vi) | Invoice value charged by C to D, a retailer | | <u>1,35,000</u> |

| III. | C's liability for VAT | ₹ | ₹ |
|------|---------------------------|------------|---------------------|
| | Tax on the sale price | | 15,000 |
| | Less: Set-off of VAT paid | | |
| | To B | 12,500 | |
| | To other suppliers | <u>250</u> | <u>12,750</u> |
| | Net Tax payable | | <u>2,250</u> |

When D sells the goods to the consumers, the position would be as under:

| Sl. No. | Particulars | ₹ |
|---------|--|-----------------|
| (i) | D's cost of goods (VAT paid available as set off ₹ 15,000) | 1,20,000 |
| (iii) | Expenses incurred and profit earned by D | <u>20,000</u> |
| (iv) | Sale price of goods | 1,40,000 |
| (v) | VAT on the above @ 12.5% | <u>17,500</u> |
| (vi) | Invoice value charged by D to the consumers | <u>1,57,500</u> |

| IV. | D's liability for VAT | ₹ |
|-----|--------------------------------|---------------------|
| | Tax on the sale price | 17,500 |
| | Less: Set-off of VAT paid to C | <u>15,000</u> |
| | Net Tax Payable | <u>2,500</u> |

Total recovery

It would be seen from the above illustration that VAT is collected at each stage of production or distribution till the goods reach the hands of ultimate consumer. The revenue collection to the department is provided in the table given below:

| Sl. No. | Particulars | ₹ |
|---------|--|----------------------|
| (i) | Paid by suppliers selling raw materials to A | 2,500 |
| (ii) | Net tax paid by A on his sales to B | 2,500 |
| (iii) | Paid by suppliers selling other materials to B | 2,500 |
| (iv) | Net tax paid by B | 5,000 |
| (v) | Paid by suppliers selling packing materials to C | 250 |
| (vii) | Net tax paid by C | 2,250 |
| (viii) | Net tax paid by D | <u>2,500</u> |
| | Total Recovery of Revenue | <u>17,500</u> |

Illustration 1: If inputs worth ₹ 1,00,000 are purchased and sales are worth ₹ 2,00,000 in a month, input tax rate and output tax rate are 4% and 12.5% respectively, then what will be the input tax credit/set-off and net VAT payable?

Solution:

| S.No. | Particulars | ₹ |
|-------|--|-----------------|
| (a) | Inputs tax paid within the month (₹ 1,00,000 x 4%) | 4,000/- |
| (b) | Input tax credit of input tax paid | 4,000/- |
| (c) | Output tax payable (₹ 2,00,000 x 12.5%) | 25,000/- |
| (d) | Net VAT payable [(c) – (b)] | 21,000/- |

Illustration 2: Compute the VAT payable and VAT credit to be carried forward, if any, from the following particulars:

| | |
|---------------------------------|-------------|
| Inputs purchased within a month | ₹ 10,00,000 |
| Outputs sold in the month | ₹ 7,50,000 |
| Input tax and output tax rate | 12.5% |

Solution:

| S.No. | Particulars | ₹ |
|-------|---|---------------|
| (a) | Input tax paid @ 12.50% on ₹ 10,00,000 | 1,25,000 |
| (b) | Tax @ 12.5% on sale of goods of ₹ 7,50,000/- during the month | 93,750 |
| | Net VAT payable during the month (b) – (a) | NIL |
| | Tax credit to be carried to the next month (a) – (b) | 31,250 |

Illustration 3: Compute the net VAT payable and VAT credit to be carried forward, if any, from the following particulars:

| | ₹ |
|--|--------|
| Tax paid on purchases made in the State within a month | 10,000 |
| Tax charged for sales in the State within a month | 4,500 |
| CST charged for inter-state sales within a month | 15,000 |

Solution:

| | ₹ |
|---|------------|
| Net VAT payable (₹ 4,500 – ₹ 10,000) | Nil |
| Excess credit (₹ 10,000 – ₹ 4,500) | 5,500 |
| CST to be paid to Government (₹ 15,000 – ₹ 5,500) | 9,500 |
| VAT credit to be carried forward | NIL |

Illustration 4: From the following particulars, compute the Net VAT liability of the month and VAT credit to be carried forward, if any.

| | <i>Particulars</i> | <i>(₹)</i> |
|-------|---|------------------|
| (i) | <i>Inputs/supplies purchased during the month</i> | <i>1,00,000</i> |
| (ii) | <i>Capital goods purchased during the month</i> | <i>10,00,000</i> |
| (iii) | <i>Sales during the month</i> | <i>10,00,000</i> |

VAT rate on purchases of inputs, capital goods and sales is 12.5%.

Solution:

| <i>Particulars</i> | <i>(₹)</i> |
|---|-----------------|
| VAT paid on procurement of inputs/supplies | 12,500 |
| VAT paid on procurement of capital goods | <u>1,25,000</u> |
| VAT credit available in the month | 1,37,500 |
| Output VAT on sales | 1,25,000 |
| Net VAT payable during the month | Nil |
| Carry over of tax credit for set off during the next month | 12,500 |

Illustration 5: R. Ltd. of Mumbai made a total purchases of input and capital goods of ₹ 60,00,000 during the month of February, 2014. The following further information is available:

- Goods worth ₹ 15,00,000 were purchased from Assam on which CST @ 2% was paid.
- The purchases made in February, 2014 include goods purchased from unregistered dealers amounting to ₹ 18,50,000.
- It purchased capital goods (not eligible for input tax credit) worth ₹ 6,50,000 and those eligible for input tax credit for ₹ 9,00,000.
- Sales made in Mumbai during the month of February, 2014 is ₹ 10,00,000 on which VAT at 12.5% is payable.

All purchases given are exclusive of tax. VAT @ 4% is paid on local purchases. Calculate the:

- amount of purchases eligible for input tax credit.
- amount of input tax credit available for the month of February, 2014.
- Net VAT payable for the month of February, 2014.

Input tax credit on eligible capital goods is available in 36 equal monthly installments.

Solution:

Computation of purchases eligible for input tax credit, input tax credit available for February, 2014 and net VAT payable for the month:-

| <i>S. No.</i> | <i>Particulars</i> | <i>₹</i> |
|---------------|---|----------|
| (i) | Goods purchased from Assam on which CST @ 2% was paid | - |

| | | |
|-------|---|-------------------------|
| | <i>(Purchases made from outside the State on which CST is payable are not eligible for input tax credit)</i> | |
| (ii) | <i>Purchases from unregistered dealers</i> <i>(Purchases from unregistered dealers are not eligible for input tax credit)</i> | - |
| (iii) | <i>Capital goods eligible for input tax credit</i> | 9,00,000 |
| (iv) | <i>Balance purchases liable to VAT and thus, are eligible for input tax credit</i> | <u>11,00,000</u> |
| | $(₹ 60,00,000 - (₹ 15,00,000 + ₹ 18,50,000 + ₹ 6,50,000 + ₹ 9,00,000))$ | |
| | <i>Purchases eligible for input tax credit</i> | <u>20,00,000</u> |
| | <i>VAT paid on purchases eligible for input tax credit</i> $(₹ 11,00,000 \times 4\%)$ | 44,000 |
| | <i>VAT paid on capital goods eligible for input tax credit (input tax credit available in 36 equal monthly installments)</i> $\left[\frac{₹ 9,00,000 \times 4\%}{36} \right]$ | <u>1,000</u> |
| | <i>Input tax credit available for February, 2014</i> | <u>45,000</u> |
| | <i>Output VAT payable</i> $(₹ 10,00,000 \times 12.5\%)$ | 1,25,000 |
| | <i>Less: Input tax credit available</i> | <u>45,000</u> |
| | <i>Net VAT payable</i> | <u>80,000</u> |

5.8 Composition scheme for small dealers

(1) **Threshold for registration:** A dealer is a person who purchases, sells, supplies or distributes the goods in the course of his business for valuable consideration. The White Paper provides that registration for VAT is not compulsory for dealers having gross turnover up to ₹ 5 lakh. However, subsequently States have been allowed to increase such threshold limit to ₹ 10 lakh.

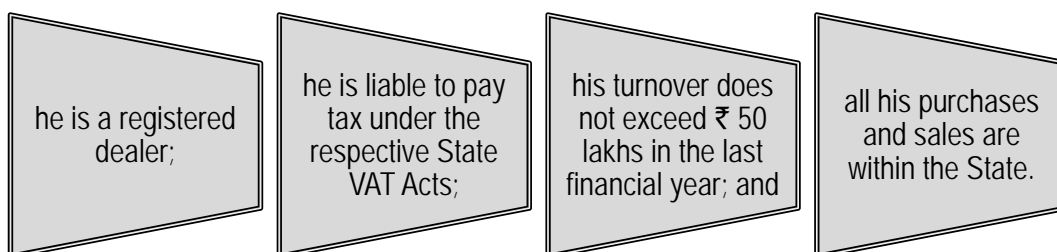
Most of the States have kept the threshold limit for registration at ₹ 5 lakh. In case of Karnataka, the limit is ₹ 2 lakh.

(2) **Composition Scheme:** VAT system requires elaborate record keeping and detailed accounting, which increases the compliance cost of the dealers. Small dealers generally do not have the expertise and the knowledge to comply with requirements relating to records and accounts.

The White Paper, therefore, has provided a simple **optional composition scheme** for small registered dealers where tax is paid at a small percentage of the gross turnover. The scheme entails a simpler method of accounting for VAT. Input tax credit is not allowed under the scheme and the dealer opting for the scheme is not authorized to issue Vatable invoices.

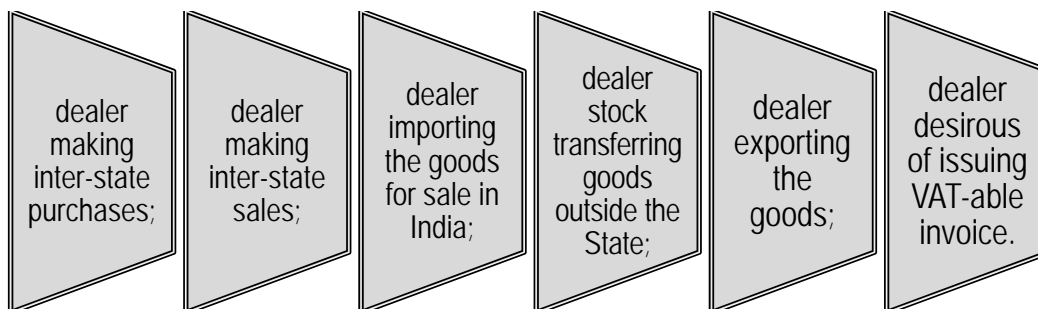
Composition rate: The Empowered Committee has permitted the States to reduce the rate of composition tax to as low as 0.25 %. The composition tax at the rate decided by the State Governments can be levied on the taxable turnover. The State Governments may also provide for different types of composition schemes to be notified for different classes of retailers.

(3) **Eligible dealers:** A dealer is eligible to opt for the Composition Scheme (scheme) if-



[Fig. 11]

(4) **Non-eligible dealers:** The following dealers are not eligible for the scheme:



[Fig. 12]

(5) **Exercising of option:** The dealer should not have any stock of goods which are brought from outside the State on the day he exercises his option to pay tax by way of composition. He should not use any goods brought from outside the State after such date. He should also not claim input tax credit on the inventory available on the date on which he opts for composition scheme.

(6) **Advantages and disadvantages of the scheme:** The advantages and disadvantages of the Scheme are tabulated in figure 13 given in the next page.

The scheme is basically useful for the dealers –

- (i) who directly sell to final consumers, who cannot avail any input tax credit; or
- (ii) who cannot maintain elaborate records required for availing input tax credit.

| ADVANTAGES | DISADVANTAGES |
|--|---|
| <ul style="list-style-type: none"> • Minimum records: If a dealer avails this scheme, he need not maintain any statutory records as prescribed under the respective State VAT Acts. Only the records for purchase, sales, inventory have to be maintained. • Simple tax calculation: Generally, a small tax is payable (normally 4% or lower). • Simple return: A simple return form covers longer return period under such schemes. | <ul style="list-style-type: none"> • Non availability of input tax credit: A dealer opting for the scheme cannot avail input tax credit on purchases made by him. Thus, it adds to the cost of the goods as the tax cannot be passed on. • VAT chain gets broken: Since, a buyer purchasing from the composition dealer does not get any tax credit, the VAT chain gets broken, and the benefit of tax paid earlier is not passed on to the subsequent buyers. This ultimately leads to cascading of taxes. |

[Fig. 13]

5.9 VAT and Sales Tax Incentives

During the sales tax regime, State Governments used to offer sales tax incentives to new industries set up in the State with the ultimate objective of the development of the State. By and large the incentives were given in three modes as described below:-

| Exemption from tax | Deferment of tax liability | Remission of tax |
|--|---|--|
| <ul style="list-style-type: none"> • Neither tax charged nor tax collected by the eligible industry. • Input tax also not payable on purchases of raw materials. • Exemption ceases either with the expiry of exemption period or the exemption amount, whichever occurs first. | <ul style="list-style-type: none"> • Tax collected from the buyers but the payment thereof to the Government deferred. • After the expiry of the prescribed period, the liability to be paid in specified installments. | <ul style="list-style-type: none"> • Tax collected from the buyers but the payment thereof remitted. • Input tax paid on purchases by the unit to be refunded. |

[Fig. 14]

However, any exemption from tax is against the principles of VAT as it breaks the VAT chain. VAT system works on the basis of tax credit passed at each stage of production and

distribution through issuance of tax invoices. Therefore, the dealers effecting exempted sales break the VAT chain as they are not allowed to avail input tax credit and issue tax invoices to pass on the credit.

State Governments, therefore, stopped giving incentives to new industries after January, 2000. However, incentives already given to industries set up prior to January, 2000 were continued under the VAT regime by converting them to deferral schemes so that such industries could pass on the benefit of VAT to their buyers.

5.10 VAT and Works Contract

(1) Works contract liable to VAT: As learned in previous Unit, works contract is a deemed sale, which involves transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. **Sub-clause (b) of clause (29A) of the Article 366 of the Constitution *inter alia* provides that the term "tax on sale or purchase of goods" include "a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract."** Therefore, works contract transactions, when executed within the State, are subject to VAT.

The definition of works contract provided under various State VAT laws are largely based on the definition of works contract as provided under Central Sales Tax Act [Refer Unit-4 for the definition of works contract under CST Act].

Example: Construction of a new building, turnkey projects including engineering, procurement and construction (EPC) or commissioning projects etc. are works contracts.

(2) Taxable turnover for works contract: Works contract is a composite contract of goods and services. While VAT is leviable on goods involved in the execution of works contract, service tax is levied on value of services.

(i) Taxable turnover where labour and other service charges are quantifiable

Taxable turnover to be contract price less labour and other service charges: Turnover for imposition of VAT in relation to the transfer of property in goods (whether as goods or in some other form) involved in execution of a works contract, shall mean sale price of goods in which there is transfer of property. The amount representing labour and other service charges incurred for such execution has to be excluded from the contract price to arrive at the taxable turnover for imposition of VAT [Refer *Gannon Dunkerly decision* – discussed in the previous Unit].

(ii) Taxable turnover where labour and other service charges are not quantifiable

(a) Taxable turnover to be cost of goods plus cost of transfer/conversion and profit margin: Where such labour and other service charges are not quantifiable, the sale price shall be the cost of acquisition of the goods and the margin of profit on them prevalent in the trade plus the cost of transferring the property in the goods and all other expenses in relation thereto till the property in them, whether as such or in any other form, passes to the contractee and where the property passes in a different form, the sale price shall include the cost of conversion.

(b) **Standard rate of deduction:** Alternatively, dealers can also make use of the standard rate of deduction provided in the State VAT laws for deducting labour and other like charges in the contract to arrive at the taxable turnover for imposition of VAT.

(3) **Tax rates:**

(a) **Schedule rate:** As a basic feature, tax is chargeable on the transfer of property in the goods involved in the execution of a works contract at the rates prescribed for the concerned goods in the schedules of the concerned State VAT legislation. Where the value of each item of material transferred in the course of execution of a works contract is identifiable, tax is charged on the value of individual items of materials as provided under the schedules to the concerned State VAT legislation. The contractor is entitled to avail input tax credit on inputs.

(b) **Revenue neutral rate:** If the values of individual goods are not identifiable, contractor can pay tax at Revenue Neutral Rate (RNR - generally 12.5%/13.5%) after deducting the value attributable towards labour and other like charges.

Illustration 6: Determine the taxable turnover, input tax credit and net VAT payable by a works contractor from the details given below on the assumption that the contractor maintains sufficient records to quantify the labour charges. Assume output VAT at 12.5%.

| | Particulars | ₹ (in lakh) |
|-------|--|-------------|
| (i) | Total contract price (excluding VAT) | 100 |
| (ii) | Labour charges paid for execution of the contract | 35 |
| (iii) | Cost of consumables used not involving transfer of property in goods | 5 |
| (iv) | Material purchased and used for the contract taxable at 12.5% VAT (VAT included) | 45 |

The contractor also purchased a plant for use in the contract for ₹ 10.4 lakh (inclusive of VAT). In the VAT invoice relating to the same, VAT was charged at 4% separately. Assume 100% input tax credit is available on capital goods immediately.

Make suitable assumption wherever required and show the working notes.

Solution: Under works contract, where labour and service charges are quantifiable, the turnover for imposition of VAT is the contract price less the labour and other charges incurred for such execution.

Computation of the taxable turnover, input tax credit and net VAT payable by the works contractor:

| Particulars | ₹ | ₹ |
|--|-----------------|-------------|
| Total contract price | | 1,00,00,000 |
| Less : Deductions admissible | | |
| 1. Labour charges paid for executing the contract | 35,00,000 | |
| 2. Cost of consumables in which no property is transferred | <u>5,00,000</u> | |

| | | |
|---|---------------|------------------|
| Total deductions | | <u>40,00,000</u> |
| Taxable turnover | | <u>60,00,000</u> |
| Output VAT payable @ 12.5% (on ₹ 60,00,000) [A] | | 7,50,000 |
| Less : Admissible input tax credit | | |
| 1. On material (₹ 45,00,000 x 12.5/112.5) | 5,00,000 | |
| 2. On plant (₹ 10,40,000 x 4/104) | <u>40,000</u> | |
| Input tax credit [B] | | <u>5,40,000</u> |
| Net VAT payable [A] – [B] | | <u>2,10,000</u> |

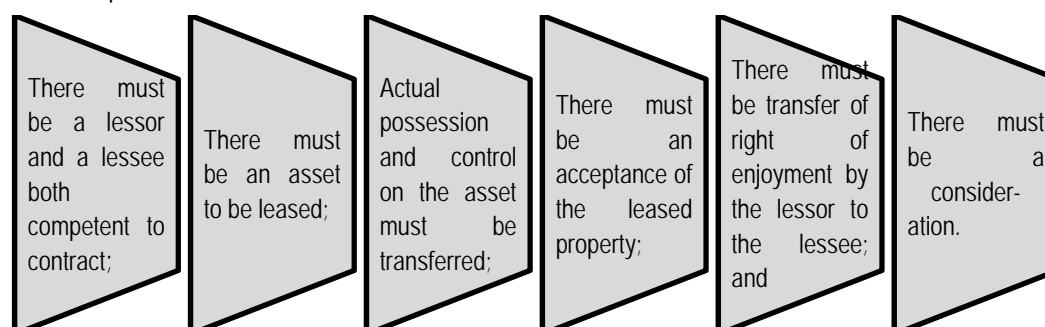
(4) **Composition Scheme:** The salient features of the Composition Scheme provided under various State VAT Acts are:

- VAT legislations provide for an **optional** Composition Scheme to collect tax on works contracts in a simple manner so as to minimize the inconvenience caused to the assesseees.
- Tax is paid at a composite rate on the gross contract value. The tax rate is generally lower in such scheme.
- Input tax credit is not allowed under the scheme. However, in some States (e.g. Maharashtra) partial input tax credit is granted.

(5) **Input tax credit on capital goods:** Several kinds of works contracts do not involve any manufacturing or processing of goods e.g. contracts for construction of roads, bridges, etc., and yet capital goods of substantial value are used in the execution of such contracts. Majority of the VAT legislations provide for availing of input tax credit on capital goods **only** where such goods are used in manufacturing or processing of goods.

5.11 VAT and Lease Transactions

(1) **What is a lease?** A lease is a special type of transaction, under which a party owning the asset (called the 'lessor') provides that asset for use over a certain period of time to another party (called the 'lessee') for consideration (called 'rentals'). The legal ownership of the asset remains with the lessor, but the lessee retains the possession and uses the asset over the period of the lease. The characteristics of a lease can be summarized as under:



[Fig. 15]

(2) **Lease transactions are liable to VAT:** As learned in previous Unit, lease is a deemed sale. Sub-clause (d) of clause (29A) of Article 366 of the Constitution *inter alia* provides that "tax on sale or purchase" includes "a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration." In common parlance, these transactions are known as lease of goods and the tax on these sales is referred to as "lease tax".

Therefore, lease transactions when effected intra-state are liable to VAT. Inter –state leasing is subject to CST.

However, if an asset is given on rent for use but the complete possession and control of the asset is not handed over, the transaction is not a deemed sale as it is not a transfer of right to use. In such a case, it becomes a service liable to service tax.

Example: If a machinery is given on rent but the operator thereof is provided by the person giving the machinery for use, the transaction becomes a service as complete possession and control of the asset is not handed over. However, if the machinery is given on rent with full control and possession (the person taking the machine on hire is free to use it as per his requirements) then the transaction becomes a deemed sale.

Sub-lease: Transfer of the right to use goods does not require that the goods should be owned by the person effecting such transfer. Accordingly, sub-lease of an asset too can be taxed, unless the State Value Added Tax law has provided for the levy of tax only at one stage.

(3) **Taxable event:** Taxable event is the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration. Thus, a transfer which is gratuitous is not taxable. Likewise, transfer of the right to use *immovable property* - not being goods - like renting a house or factory is not taxable.

(4) **Taxable turnover:** Normally, the sale price means the amount of valuable consideration paid or payable for any sale made during the given period. It also includes some other charges before delivery thereof. However, certain States have provided for the deduction of interest or finance charges for the purpose of determination of sale price/taxable turnover.

(5) **Input tax credit:**

- (i) **Input tax credit allowed on purchase of the asset which is to be leased:** The lessor pays VAT (input tax) at the time of procurement of goods. However, liability to pay VAT (output tax) on lease rentals is spread over the tenure of the lease. Therefore, some States provide for utilization of input tax credit for paying output tax only over the entire period of lease. This results in accumulation of input tax credit in the hands of the lessor for a long period of time. However, States like Maharashtra have provided for immediate utilization of such input tax credit against payment of any tax.
- (ii) **Input tax credit as capital goods:** The assets given on lease are generally capitalized by the lessor in his books and are treated as capital assets. Thus, provision relating to input tax credit on capital goods apply in this case also, e.g. if VAT law provides to give

input tax credit on capital goods in 36 months, then irrespective of period of lease, input tax credit would be available only in 36 months.

(6) Maintenance of leased asset: Maintenance of the leased asset involving supply of materials for maintenance/repair, which are in the nature of consumables, by the lessor does not amount to works contract, as there is no transfer of property in such materials to the lessee. Thus, there would be no VAT on the value of the consumables used during maintenance/repair of the asset. In such a case, the contract becomes a service contract liable to service tax.

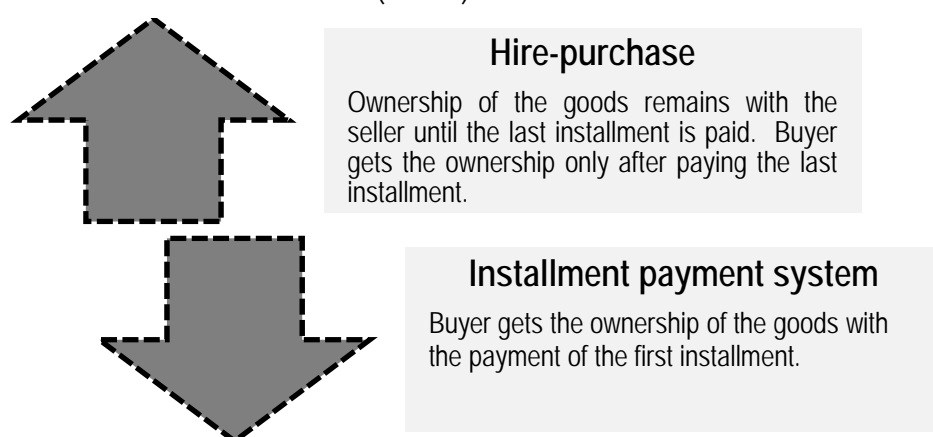
However, if parts are also supplied during the maintenance, then such contract becomes a works contract liable to VAT as there is a transfer of property in goods involved in the execution of the contract. In such a case, the materials required for such maintenance/repair would be input for sale and input tax credit will be available.

(7) Sale of leased asset after lease period: Sale of a leased asset after the lease period is over is taxable in the same manner in which normal sale of such asset would have been taxed. Normally, such sale is effected to the same lessee and hence such sale would be a local one exigible to tax under the VAT laws of the State in which the asset is located.

5.12 VAT and Hire-Purchase Transactions

(1) Hire-purchase: Hire-purchase is a type of installment credit under which the hire purchaser, called the hirer, agrees to take the goods on hire at a stated rental, which is inclusive of the repayment of principal as well as interest, with an option to purchase. Under this transaction, the hirer acquires the goods immediately on signing the hire-purchase agreement but the ownership or title of the same is transferred only when the last installment is paid.

In the case of hire-purchase, property passes in the goods when the hirer exercises his option to purchase the goods subject to the fulfillment of the terms of the agreement and then the transaction fructifies into a concluded (normal) sale.



[Fig. 16]

It may be noted that in hire-purchase transactions, the word 'purchase' is of primary significance while 'hire' is an adjunct. In a contract of hire-purchase the contract is for 'purchase' with the attributes of hire and not 'hire' with the attributes of a purchase.

(2) Hire-purchase liable to VAT: As learned in previous Unit, hire purchase is a deemed sale. Sub-clause (c) of clause (29A) of Article 366 of the Constitution *inter alia* provides that "tax on sale or purchase" includes "a tax on the delivery of goods on hire-purchase or any system of payment by installments."

By virtue of this sub-clause, State legislations have been able to deem that a sale takes place on the date of delivery of the goods on hire purchase notwithstanding the fact that the option to purchase is exercised only at the end when the title of the goods as per the terms stands transferred from the dealer to the hirer.

Therefore, intra-state hire-purchase transactions are liable to VAT. Inter-state hire-purchase transactions are subject to CST.

Under VAT laws of different States, hire-purchase and installment sales are at par with normal sales and hence the provisions of the State VAT laws as applicable to normal sales are equally applicable to hire-purchase and installment sales.

Pure financial transactions (Hire-purchase finance) not liable to VAT: Transactions which are purely of a financial nature between the financier and the hirer are not covered by sub-clause (c) of clause (29A) of Article 366. Where it is explicit in the hire-purchase contract that the reservation of title by the financier is merely a matter of security, such a transaction is a pure financial transaction. There is no real sale of the asset by the financier to the hirer and thus, such pure financial transactions are not liable to VAT.

(3) Taxable event: The definition of sale under value added tax laws of various States provides that the taxable event will be the actual or physical delivery of goods on hire purchase or under any system of payment by installments. It is implicit that such transaction should be for monetary consideration.

It is important to note that in case of hire-purchase transactions, the delivery of the goods has been made the taxable event and not the completed sale on payment of the last installment.

(4) Input tax credit: The hire purchase transaction is at par with normal sale transaction. Therefore normal provisions relating to input tax credit apply in this case also. However, some States have provided for *prorata* credit.

Some special aspects:

- **Liability to tax when sale concludes:** A debatable question which arises is whether in case of hire-purchase, VAT will have to be paid again at the time when transaction fructifies into a concluded sale, inspite of tax having been deposited on installment (payable as and when due, whether or not recovered). Answer to this problem depends mostly upon the provisions of the VAT laws of the States in which the goods are located when the transaction fructifies into a concluded sale.

One view is that when the transaction fructifies into a concluded sale, tax will not be payable as tax has already been paid on installments. However the other view is that,

earlier tax was a tax on delivery of the goods on hire-purchase or installment. Therefore, at that time only the consideration received for hire-purchase or installment was taxed and the consideration receivable at the time of concluded sale does not get taxed. Hence, tax is payable again on the fructified sale on the depreciated value of the asset or its market value. The second view appears to be logical. However, if no consideration is payable on fructified sale, then tax is not attracted.

- **Finance charges/interest:** It is common knowledge that the installment fixed for payment in the case of a hire-purchase arrangement involves an element of interest or finance charges in addition to the price of the goods sold. While some of the State VAT legislations have provided for deduction of such interest or finance charges in arriving at the sale price to be treated as turnover in a hire purchase transaction, some States have not done so.
- **Goods returned:** VAT is payable on the date of delivery of the goods. If for any reason the goods are returned, then refund of tax will have to be claimed as per the provisions of respective State VAT laws. In substance, this is a sales return. Many States have provided a time limit for granting the claim of goods returned. Therefore, if the goods are not returned during that specified period, no benefit will be available.
- **Unpaid installments/ forfeited installments:** If for any reason, the transaction of hire purchase fails, then the vendor takes possession of the goods. Normally, in such cases the installment received for the intervening period are forfeited.

5.13 VAT and sale of food articles

As per clause (f) of Article 366 (29A) of the Constitution, "tax on sale or purchase" includes "a tax on supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating) where such supply or service is for cash, deferred payment or other valuable consideration.

Thus, sale of food in hotel is a deemed sale liable to VAT. Service tax law considers that such a transaction involves element of service also and thus, the service portion involved in such a sale is declared to be a service liable to service tax.

5.14 Deficiencies in State-Level VAT

The State-Level VAT in India is not a perfect system of VAT. It has the followings flaws:

- (i) **Non-uniformity in VAT rates across the country:** One of the primary reasons for implementation of VAT had been to do away with the multiple rates of sales tax prevalent in different States leading to unhealthy competition between the States and distorted economic development of the country. However, under VAT regime also States have deviated from the agreed rate structure prescribed by the White Paper to suit their individual requirements. Thus, in the present scenario also, VAT rates are not uniform all over India.

- (ii) **Non-uniformity in provisions of VAT laws across the country:** The provisions of VAT Acts and Rules as also the varied procedures are not uniform across the country.
- (iii) **CST non-Vatable:** Non-availability of credit of central sales tax leads to cascading of taxes.
- (iv) **Double taxation:** There is no clear distinction between goods and services which leads to double taxation as both Union and State Governments tax the same transaction in different ways i.e., both service and VAT tax are levied on the same transaction. Union Government treats the transaction as service and levies service tax while State Governments treat the transaction as sales and levy State VAT. For instance, both VAT and service tax are levied in case of software.
- (v) **Hurdles in movement of inter-state goods:** Since, the State-Level VAT is not a National VAT, goods moving from one State to another have to cross through check posts at State borders which causes delays, corruption and harassment.

5.15 VAT procedures²

(1) **Registration:** Registration is the process of obtaining certificate of registration (RC) from the authorities. A dealer registered under a VAT Act is called a registered dealer. Any dealer, who intends to carry on the business of purchase and sale of goods in the State and is liable to pay tax, cannot carry on the business unless he is registered and holds a valid registration certificate under the Act [*Refer Heading 5.8 of this Unit for discussion on threshold for registration*].

Tax Payer's Identification Number (TIN): TIN (Tax Payer's Identification Number) is the registration number of the dealer consisting of 11 digit numerals throughout the country. First two characters represent the State code as used by the Union Ministry of Home Affairs. The set of the next nine characters are however, different in different States.

(2) **Invoice:** Invoice is a document listing goods sold with price, tax charged and other details as may be prescribed and issued by a dealer authorized under the Act. The White Paper provides that:

- (i) Every registered dealer whose turnover of sales exceeds the specified amount shall issue to the purchaser a serially numbered tax invoice, cash memo or bill with the prescribed particulars.
- (ii) The tax invoice shall be dated and signed by the dealer or his regular employee, showing the required particulars.
- (iii) The dealer shall keep a counterfoil or duplicate of such tax invoice duly signed and dated.

² Though the basic concepts relating to VAT apply in respect of all the States, the procedural law differs on many counts from State to State. Therefore, a bird's eye view of the significant VAT procedures has been given in this Unit with the objective of familiarizing the students with the basic aspects of significant procedures under VAT Laws.

Importance of VAT invoice (tax invoice): Invoices are crucial documents for administering VAT. In the absence of invoices, VAT paid by the dealer on the inputs/capital goods cannot be claimed as set off. Invoices should be preserved with full care. In case any original invoice is lost or misplaced, a duplicate authenticated copy must be obtained from the issuing dealer.

Contents of VAT invoice: Generally, the various legislations provide that the tax invoice should have the following contents:

- (i) the words 'tax invoice' in a prominent place;
- (ii) name and address of the selling dealer;
- (iii) registration number of the selling dealer;
- (iv) name and address of the purchasing dealer;
- (v) registration number of the purchasing dealer (may not be required under all VAT legislations);
- (vi) pre-printed or self-generated serial number;
- (vii) date of issue;
- (viii) description, quantity and value of goods sold;
- (ix) rate and amount of tax charged in respect of taxable goods;
- (x) signature of the selling dealer or his regular employee duly authorized by him for such purpose.

(3) Returns: A registered dealer has to required to file monthly/quarterly/annual returns as per the provisions of the State Acts/Rules along with the tax payment challans. The returns should disclose the details like output tax liability, value of input tax credit, payment of VAT.

The dealer also has the option of filing the revised return within the stipulated time period under the VAT provisions. The composition dealers are also required to file the return on periodical basis as stipulated under the respective State VAT provisions.

(4) Audit by Chartered Accountants: Apart from the Departmental Audit, many States have also incorporated the concept of audit of accounts by Chartered Accountants. However, auditing for all types of dealers may not be necessary. For example, in Maharashtra and Rajasthan, the dealer whose turnover exceeds ₹ 40 lakhs in any year is required to get his accounts audited in respect of such year.